INFORMATIONAL

Displaying Customer Limit Orders

NASD Reiterates Obligations To Display Customer Limit Orders Pursuant To SEC Rule 11Ac1-4

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
- Senior Management
- Systems
- Trading & Market Making

KEY TOPICS

- Limit Orders
- Order Handling Rules
- SEC Rule 11Ac1-4 (Display Rule)

Executive Summary

The National Association of Securities Dealers, Inc. (NASD®), after consultation with the staff of the Securities and Exchange Commission (SEC or Commission), is reiterating the limit order display obligations imposed on members under SEC Rule 11Ac1-4 (Display Rule). One of the primary purposes of this *Notice* is to reiterate that the 30-second requirement to display limit orders does not operate as a safe harbor.

Questions/Further Information

Questions concerning this *Notice* may be directed to Bob Aber, Senior Vice President and General Counsel, The Nasdaq Stock Market, Inc., at (202) 728-8290; or the Market Regulation Department Legal Section, NASD Regulation, Inc. (NASD Regulation℠), at (301) 590-6410.

Discussion

In August 1996, the SEC adopted its Order Handling Rules, which included the Display Rule governing the display of customer limit orders. The Display Rule requires Market Makers to display the full price and size of qualifying limit orders in their quotes, subject to certain enumerated exceptions. Once a customer limit order is obligated to be publicly displayed in accordance with the Display Rule, the Display Rule requires that such a customer limit order be displayed "immediately," unless a specific exception to the rule applies. The SEC has indicated that a Market Maker "must display the order as soon as is practicable after receipt which, under normal market conditions, would require display no later than 30 seconds after receipt".[1]

Firms are afforded a brief opportunity, pursuant to the exceptions contained in the Display Rule[2], to determine whether to display, execute, or route a customer limit order, but under no circumstances can a firm intentionally delay—or rely on an automated system that is programmed to delay—the display of limit orders as a matter of course. As to the specific time parameter in which a Market Maker must act to display, execute, or route a customer limit order, firms should take such action as soon as possible, but no later than 30 seconds after receipt. The 30-second period is an outer limit and under normal market conditions, Market Makers should take such action well before the termination of the 30-second period for most of their customer limit orders.

In determining under what circumstances Market Makers have violated the Display Rule, notwithstanding the fact that a Market Maker has displayed the customer limit orders within 30 seconds after receipt, a number of factors will be evaluated. The following factors should be taken into consideration when evaluating the immediacy with which a customer limit order was displayed:

- the volume of customer limit orders in a particular issue;
- the amount of contemporaneous transactions in the issue by the Market Maker; and
- the volatility of the issue.

To the extent that a firm has determined as a matter of business practice always to display customer limit orders (or otherwise automated the handling of its limit orders such that no human action is required or involved in the handling of the order), the firm should take action immediately without delay (*i.e.*, within a matter of seconds depending upon the capacity of the firm's system or limit order queues) and any systematic delay in the handling of the orders, regardless of how long, would constitute a violation of the Display Rule. Given the operational differences among firms and the different market attributes of particular securities, however, there is no "bright line, absolute" standard governing the number of seconds a Market Maker has to complete its choice of displaying, executing, or routing a customer limit order. Accordingly, a firm may operate an automated system that defaults to display customer limit orders within 30 seconds of receipt, so long as the firm makes every effort to display the limit orders as soon as possible manually or otherwise.

Endnotes

[1] Order Execution Obligations, 61 Fed. Reg. 48290 (1996) at 48304.

[2] The requirements of the Display Rule do not apply to any customer limit order that:

- is executed upon receipt of the order;
- a customer expressly requests not be displayed;
- is an odd-lot order;
- is a block size order, unless the customer requests that the order be displayed;
- is delivered immediately upon receipt to a qualifying system or ECN;
- is delivered immediately upon receipt to another Market Maker that will display the order or otherwise comply with the rule; or
- is an 'all or none' order.