

Special NASD Notice to Members 99-39

The NASD Prepares For Move To Decimals

Suggested Routing

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Executive Summary

The National Association of Securities Dealers, Inc. (NASD®) is preparing to move from fractional pricing to decimal pricing by June 30, 2000, in order to meet the time frame established by the Securities and Exchange Commission (SEC).

The move to decimal pricing (Decimalization) means the conversion of all securities industry systems from fractional pricing to decimal pricing, *i.e.*, in dollars and cents. Decimalization is a complicated process which impacts every area of the securities industry. Each place that a system currently compiles, stores, or displays fractional pricing must be converted to accommodate decimal pricing. Any written materials containing fractional pricing must be updated to reflect decimal pricing. Adequate training for floor specialists and traders will have to be developed and provided.

The SEC-targeted conversion date is just over a year away. However, all internal tests and industry tests must be completed and all systems must be converted before the deadline of June 30, 2000 (see proposed time frame on page 259).

The NASD is sharing this information with members about this important industry-wide effort as a first step in awareness about Decimalization. In the coming months, the NASD will continue to communicate with members on a regular basis about this initiative.

This *Special Notice to Members* outlines the securities industry's efforts to prepare for trading in decimals. This outline includes background information, benefits of decimal pricing, the industry time frame, and steps firms will need to

take to prepare for the conversion. This *Special Notice* also discusses NASD participation in Securities Industry Association (SIA) activities, and the results of the SIA-commissioned industry study on message traffic and capacity.

The NASD is committed to the successful industry-wide conversion to Decimalization. We are continuing to move ahead with the SEC and Congress to achieve the SEC-proposed conversion date of June 30, 2000. We will also continue to review systems and evaluate the impact of decimal pricing and the issues associated with conversion, implementation, testing, and final cutover, keeping close at hand the NASD mission to protect market integrity, the interest of the investor, readiness of our member firms, and given the latest volume predictions for decimal trading, the technological aspects of this change.

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

Discussion

NASD member firms that are working diligently on technology initiatives such as Year 2000 and the Order Audit Trail SystemSM (OATSSM) are now just over a year away from the scheduled completion of another major initiative: Decimalization. The SEC has called for the industry-wide conversion from fractional pricing to decimal pricing to occur by June 30, 2000. The NASD is working closely with the SIA, SEC, and stock and options exchanges to ensure that all member firms are aware of the actions they need to take in order to be ready for the conversion.

History

In 1997 and 1998, congressional subcommittees were formed and hearings were held on proposed legislation that would direct the SEC to require that securities be traded in dollars and cents instead of the traditional fractions. The subcommittees found that industry representatives were committed to converting to decimals, and identified the following benefits in their research:

- Pricing is more easily understood in dollars and cents. This could bring more investors to the marketplace.
- There is an increased savings potential for investors if decimal pricing leads to smaller price increments and narrower spreads. Narrower spreads mean investors pay less in commissions.
- Decimal pricing would make U.S. markets more compatible with non-U.S. markets that already trade in decimals.

In May 1998 in testimony to the Subcommittee on Finance and Hazardous Materials, the General Accounting Office (GAO) recommended to Congress that all exchanges:

- 1) Prepare a comprehensive plan for implementing decimal trading to include interim milestones, industry-wide testing, and implementation target dates.
- 2) Work with the SIA and the SEC to delineate technical standards and specifications that receive broad industry support.

The NASD concurs with the views of the other markets that the conversion to decimal trading must be carefully organized and must occur industry-wide. Therefore, the NASD established a Decimalization Program

Management Office (DPMO) in August 1998, dedicated to managing and coordinating the conversion effort both internally and with NASD member firms. The DPMO formed project teams within all its companies, including the American Stock Exchange®, to assess the impact of this conversion on information systems. Systems inventories were validated, and all systems and applications were examined to determine the extent of changes required for decimal conversion. This process, which is very similar to the process used to assess Year 2000 impact, resulted in a comprehensive list of systems that require remediation, replacement, or retirement. Project plans and major milestones have been identified for impacted systems. The DPMO is maintaining and tracking major milestones, baselining and monitoring the progress of the conversion effort for the enterprise.

What Is Currently Happening

In line with the GAO's recommendation, the NASD is taking a proactive role with the SIA in examining both technical and business issues associated with Decimalization. Staff from the DPMO serve on the SIA Decimalization Steering Committee and the implementation, testing, and communication subcommittees. These subcommittees are taking an in-depth look at the challenges of converting to decimal trading, and will make recommendations about business and technical specifications. Some of the issues surrounding Decimalization are related to Minimum Price Variation (MPV), quoting and trading volume, new emerging trading strategies, and capacity issues.

The SIA commissioned SRI Consulting, Inc., to conduct an industry-wide survey to look at message traffic and capacity in MPV

increments of a nickel and a penny. The survey, which was released in late April, forecasts dramatic increases in quoting and message traffic, particularly with penny increments. The survey predicts increases that raise real capacity challenges for the industry as a whole. Full survey results are posted on the SIA Web Site (www.sia.com). The SIA, after conversations with the SEC in April, is currently recommending that firms plan on an MPV of a penny. The NASD continues to study the impact of a penny MPV on trading and capacity.

In addition, the SIA has targeted a time frame for the industry and the DPMO has identified project milestones to guide the member firms to the June 30, 2000 conversion date. To accomplish the conversion, firms will need to identify the systems and applications impacted by the change, remediate the code/applications, and validate through testing (internal, external, point-to-point, and industry testing). All of this needs to be done before the industry commences decimal trading.

In fact, the SIA Implementation Committee is still looking at strategies for converting to decimal trading. There are two strategies currently being discussed. In a "phase-in" cutover, issues would be converted to decimal trading letter by letter (*i.e.*, issues beginning with the letter "E"). In a phase-in implementation, firms will have to be able to process both fractions and decimals at the same time, although mixed trading will not be allowed on any single issue. The other strategy being discussed is a total industry cutover, or "big bang" implementation. Under either strategy, firms should be prepared to fall back to fractions the next trading day, should problems arise. At this point, failure scenarios have not

Proposed Time Frame

Following is the preliminary time frame currently being recommended by the SIA after conversations with the SEC:

Industry Milestone

- Identify the systems and applications impacted by the decimal conversion
- Commencement of Decimal Trading

Completion Date

August 1999
June 30, 2000

The DPMO has established potential completion dates for high-level milestones for members to consider when creating their Decimalization plans. This is a tentative schedule and subject to change.

Industry Milestone

- Identify the systems and applications impacted by the decimal conversion
- Remediate the affected code/applications
- Validate through testing – internally
- Validate through testing – point-to-point
- Industry testing
- Commencement of Decimal Trading

Completion Date

August 1999
December 1999
Dec. 1999 - Feb. 2000
March 2000
April 2000 - May 2000
June 30, 2000

The DPMO is committed to supporting your Decimalization efforts. Please direct any questions or comments to us via e-mail at decimals@nasd.com or via our toll-free phone number, (888) 227-1330.

been defined. As details on business and technical specifications become available, they will be communicated to members by the DPMO.

The SIA intends to solicit feedback from member firms through a recently distributed survey on industry preparedness. Responses to the survey will be used in conjunction with recommendations from the Steering Committee and subcommittees to develop a detailed time frame for decimal trading implementation.

What You Can Expect From The NASD

Nasdaq® is working diligently on converting its systems to trade in decimals by the SEC time frame. As more information becomes available,

the Nasdaq-Amex Market GroupSM will continue to evaluate the overall impact of schedules and conversion strategies on member firms, the individual investor, and the market as a whole.

In the meantime, member firms should expect more information about Decimalization from the DPMO. This *Notice* is the first of many communications designed to keep you informed of new developments, changes to industry schedules, testing guidelines, results of the SIA survey, and other pertinent information. This information will come in the form of articles and other communications in various NASD publications and on its various Web sites, as well as through faxes and e-mails. You can get current information on

Decimalization, including contact information by visiting the Nasdaq-Amex Newsroom Web Site (www.nasdaq-amexnews.com), and by visiting the NASD Regulation® Web Site (www.nasdr.com).

We welcome your comments and suggestions on the NASD Decimalization Program and communication methods, as well as the overall impact of Decimalization on your firm. Please contact us via e-mail at decimals@nasd.com or via our toll-free phone number, (888) 227-1330. We will make every effort to respond to you as quickly as possible.

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