

June 27, 2000

Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1001
Mail Stop 10-1

Re: **File No. SR-NASD-00-40** - Mandatory Decimalization Pricing Testing

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed please find the above-numbered rule filing. Also enclosed is a 3-1/2" disk containing the rule filing in Microsoft Word 7.0 to facilitate production of the Federal Register release.

If you have any questions, please contact Kosha K. Dalal, Office of General Counsel, NASD Regulation, Inc., at (202) 728-6903; e-mail Kosha.Dalal@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Alden S. Adkins
Senior Vice President
and General Counsel

Attachment

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C.-

Form 19b-4

Proposed Rule Change

by

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Pursuant to Rule 19b-4 under the
Securities Exchange Act of 1934

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) under the Securities Exchange Act of 1934 (“Act”), the National Association of Securities Dealers, Inc. (“NASD” or “Association”), through its wholly owned subsidiary, NASD Regulation, Inc. (“NASD Regulation”), is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to require clearing firms and market makers that are members of the NASD to conduct or to participate in the testing of their computer systems to ascertain decimal pricing conversion compatibility of those systems. Below is the text of the proposed rule change. Proposed new language is underlined.

Rule 3420. Mandatory Decimal Pricing Testing.

(a) Clearing firms and market makers of the Association must conduct or participate in the testing of their computer systems to ascertain decimal pricing conversion compatibility of such systems in such manner and frequency as the Association may prescribe.

(b) Every clearing firm and market maker required by the Association to conduct or participate in testing of computer systems shall provide to the Association such reports relating to the testing as the Association may prescribe.

(c) Clearing firms and market makers shall maintain adequate documentation of tests required pursuant to this Rule and the results of such testing for examination by the Association.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The proposed rule change was approved by the Executive Committee of the Board of Governors of NASD at its meeting on June 26, 2000, which authorized the filing of the rule change with the SEC. The Nasdaq Stock Market has been provided an opportunity to consult with respect to the proposed rule change, pursuant to the Plan of Allocation and Delegation of Functions by the NASD to its Subsidiaries. No other action by the NASD is necessary for the filing of the proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the NASD Board of Governors to adopt NASD Rules or amendments to NASD Rules without recourse to the membership for approval.

(b) Questions regarding this rule filing may be directed to Kosha K. Dalal, Assistant General Counsel, NASD Regulation, Office of General Counsel, at (202) 728-6903.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) **Purpose**

The purpose of the proposed rule change is to require clearing firms and market makers that are members of the NASD to conduct or participate in the securities industry's decimalization pricing tests to ensure that conversion to decimal pricing occurs successfully and with minimal disruption of the markets.¹ The proposed rule change will implement the SEC's *Order Directing the Exchanges and*

¹ The current practice in the U.S. equities markets is to quote security prices in fractions. Decimalization is the conversion of securities industry systems from fractional to decimal pricing. The U.S. securities markets are the only major markets that do not price securities in decimals.

*NASD to Submit a Decimalization Implementation Plan*² (“SEC Order”), which directs certain securities industry participants to develop a plan for conversion to decimal pricing. The NASD believes that the proposed rule change which mandates testing by and among securities industry participants will play a critical role in ensuring a successful conversion to decimal pricing.

To ensure that its members successfully transition to decimalization, the NASD has been working to prepare the industry for conversion to decimal pricing by requiring testing by and among industry participants.

In particular, the testing by and among industry participants mandated by the proposed rule change will be critical to: (1) ensuring compliance with the SEC Order; (2) successfully converting the U.S. market to decimal pricing; (3) minimizing any disruption to the markets as a result of such conversion; and (4) reducing the impact of conversion on investors.

The proposed rule change provides authority to the NASD to require participation in organized, industry-sponsored tests, and to require “point-to-point” testing between member firms and the NASD and other industry systems. The decimalization testing is expected to be implemented in stages.

Member testing will focus on those firms that the NASD believes could cause the most disruption to the securities markets if their computer systems were not able to accommodate decimal pricing—specifically clearing firms and market making firms. The NASD proposes to require market makers and clearing firms to conduct or participate in testing of their computer systems to ascertain the decimal pricing conversion compatibility of such systems.

In connection with the proposed rule change, the NASD intends to issue Notices to Members specifying members' reporting and testing obligations sufficiently in advance of specific testing events to provide members with adequate time to comply. While it is expected that each Notice to Members will be issued with sufficient time for members to comply with a particular testing requirement, nothing in this rule relieves member firms of their ongoing obligation to take all necessary steps so that they may function properly upon industry conversion to decimal pricing.

In addition, the proposed rule change requires firms to provide the NASD with any reports concerning the results of industry tests. Members also would be responsible for maintaining adequate documentation of any tests performed and would be required to make such documentation available for examination by the NASD staff.

To assist with reporting test results to the NASD, the staff will design a standardized format for firms to use. Individual member firm testing result reports will not be publicly available, but will be provided to the Securities and Exchange Commission upon request. However, the NASD staff will collect, review and analyze these reports and compile periodic consolidated reports that will be made available to the Securities and Exchange Commission and to others generally to evaluate the progress of the testing effort and the readiness of certain NASD members. In addition, the NASD believes that the individual reports from members will enable the NASD to identify those members that have not adequately prepared for decimal pricing conversion so that appropriate action can be taken to address

² SEC Release No. 34-42360, January 28, 2000, Order Directing the Exchanges and NASD to Submit a Decimalization Implementation Plan.

these members' deficiencies. Any member that is subject to testing and fails to participate in the tests or fails to file any required reports or surveys will be subject to disciplinary action.

(b) Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that the Association's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The NASD believes that the proposed rule is necessary to protect investors and the public interest. The proposed rule change, which requires certain members to conduct or participate in decimal pricing testing, and to file reports about the tests, will enable the NASD and the SEC to evaluate the readiness of the securities industry for decimal pricing. The scope of firms subject to the rule is limited to those firms that perform critical functions in the markets and if they were unable to perform these functions upon industry conversion to decimal pricing, could cause disruptions in the markets and, consequently, harm investors.

4. Self-Regulatory Organization's Statement on Burden on Competition

NASD Regulation does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

6. Extension of Time Period for Commission Action

Not applicable.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

The proposed rule change is designated as stated policy, practice or interpretation with respect to the meaning, administration or enforcement of an existing rule, thereby qualifying it to be effective upon filing with the Commission pursuant to Section 19(b)(3)(A) of the Act and paragraph (f)(1) of Rule 19b-4 thereunder.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

1. Completed notice of proposed rule change for publication in the Federal Register.

Pursuant to the requirements of the Securities Exchange Act of 1934, NASD Regulation has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

NASD REGULATION, INC.

BY: _____
Alden S. Adkins, Senior Vice President and
General Counsel

Date: June 27, 2000

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change
by National Association of Securities Dealers, Inc. Relating to Mandatory Decimal Pricing Testing

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on _____, the National Association of Securities Dealers, Inc. (“NASD”), through its wholly owned subsidiary, NASD Regulation, Inc. (“NASD Regulation”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD Regulation. NASD Regulation has designated the proposed rule change as stated policy, practice or interpretation with respect to the meaning, administration or enforcement of an existing rule, thereby qualifying it to be effective upon filing with the Commission pursuant to Section 19(b)(3)(A) of the Act and paragraph (f)(1) of Rule 19b-4 thereunder³. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

3 17 CFR § 240.19b-4

I. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE TERMS OF SUBSTANCE OF THE PROPOSED RULE CHANGE

NASD Regulation is proposing to add a new rule, Rule 3420, to the Conduct Rules of the National Association of Securities Dealers, Inc. ("NASD" or "Association"), to require clearing firms and market makers that are members to conduct or participate in the testing of their computer systems to ascertain decimal pricing conversion compatibility of those systems. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

Rule 3420. Mandatory Decimal Pricing Testing.

(a) Clearing firms and market makers of the Association must conduct or participate in the testing of their computer systems to ascertain decimal pricing conversion compatibility of such systems in such manner and frequency as the Association may prescribe.

(b) Every clearing firm and market maker required by the Association to conduct or participate in testing of computer systems shall provide to the Association such reports relating to the testing as the Association may prescribe.

(c) Clearing firms and market makers shall maintain adequate documentation of tests required pursuant to this Rule and the results of such testing for examination by the Association.

II. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE PURPOSE OF, AND STATUTORY BASIS FOR, THE PROPOSED RULE CHANGE

In its filing with the Commission, NASD Regulation included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below.

NASD Regulation has prepared summaries, set forth in Sections (A), (B), and (C) below, of the most significant aspects of such statements.

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) **Purpose**

The purpose of the proposed rule change is to require clearing firms and market makers that are members of the NASD to conduct or participate in the securities industry's decimalization pricing tests to ensure that conversion to decimal pricing occurs successfully and with minimal disruption of the markets.⁴ The proposed rule change will implement the SEC's *Order Directing the Exchanges and NASD to Submit a Decimalization Implementation Plan*⁵ ("SEC Order"), which directs certain securities industry participants to develop a plan for conversion to decimal pricing. The NASD believes that the proposed rule change which mandates testing by and among securities industry participants will play a critical role in ensuring a successful conversion to decimal pricing.

To ensure that its members successfully transition to decimalization, the NASD has been working to prepare the industry for conversion to decimal pricing by requiring testing by and among industry participants.

In particular, the testing by and among industry participants mandated by the proposed rule change will be critical to: (1) ensuring compliance with the SEC Order; (2) successfully converting the

⁴ The current practice in the U.S. equities markets is to quote security prices in fractions. Decimalization is the conversion of securities industry systems from fractional to decimal pricing. The U.S. securities markets are the only major markets that do not price securities in decimals.

U.S. market to decimal pricing; (3) minimizing any disruption to the markets as a result of such conversion; and (4) reducing the impact of conversion on investors.

The proposed rule change provides authority to the NASD to require participation in organized, industry-sponsored tests, and to require “point-to-point” testing between member firms and the NASD and other industry systems. The decimalization testing is expected to be implemented in stages.

Member testing will focus on those firms that the NASD believes could cause the most disruption to the securities markets if their computer systems were not able to accommodate decimal pricing—specifically clearing firms and market making firms. The NASD proposes to require market makers and clearing firms to conduct or participate in testing of their computer systems to ascertain the decimal pricing conversion compatibility of such systems.

In connection with the proposed rule change, the NASD intends to issue Notices to Members specifying members’ reporting and testing obligations sufficiently in advance of specific testing events to provide members with adequate time to comply. While it is expected that each Notice to Members will be issued with sufficient time for members to comply with a particular testing requirement, nothing in this rule relieves member firms of their ongoing obligation to take all necessary steps so that they may function properly upon industry conversion to decimal pricing.

In addition, the proposed rule change requires firms to provide the NASD with any reports concerning the results of industry tests. Members also would be responsible for maintaining adequate

⁵ SEC Release No. 34-42360, January 28, 2000, Order Directing the Exchanges and NASD to Submit a Decimalization Implementation Plan.

documentation of any tests performed and would be required to make such documentation available for examination by the NASD staff.

To assist with reporting test results to the NASD, the staff will design a standardized format for firms to use. Individual member firm testing result reports will not be publicly available, but will be provided to the Securities and Exchange Commission upon request. However, the NASD staff will collect, review and analyze these reports and compile periodic consolidated reports that will be made available to the Securities and Exchange Commission and to others generally to evaluate the progress of the testing effort and the readiness of certain NASD members. In addition, the NASD believes that the individual reports from members will enable the NASD to identify those members that have not adequately prepared for decimal pricing conversion so that appropriate action can be taken to address these members' deficiencies. Any member that is subject to testing and fails to participate in the tests or fails to file any required reports or surveys will be subject to disciplinary action.

(b) Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that the Association's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The NASD believes that the proposed rule is necessary to protect investors and the public interest. The proposed rule change, which requires certain members to conduct or participate in decimal pricing testing, and to file reports about the tests, will enable the NASD and the SEC to evaluate the readiness of the securities industry

for decimal pricing. The scope of firms subject to the rule is limited to those firms that perform critical functions in the markets and if they were unable to perform these functions upon industry conversion to decimal pricing, could cause disruptions in the markets and, consequently, harm investors.

(B) Self-Regulatory Organization's Statement on Burden on Competition

NASD Regulation does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. DATE OF EFFECTIVENESS OF THE PROPOSED RULE CHANGE AND TIMING FOR COMMISSION ACTION

The proposed rule change is effective upon filing pursuant to Section 19(b)(3)(A)(i) of the Act and paragraph (f)(1) of Rule 19b-4 thereunder, in that the proposed rule change is a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule. At any time within 60 days of this filing, the Commission may summarily abrogate this proposal if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the

submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to the file number in the caption above and should be submitted by [insert date 21 days from the date of publication].

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30-3(a)(12).

Jonathan G. Katz
Secretary