

April 13, 2000

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

Re: **File No. SR-NASD-00-20** - Amendments to Rule 2320(g) and Rule 3110(b)

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed is 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 Stephanie M. Dumont, Office of General Counsel, NASD Regulation, Inc., at (202) 728-8176; e-mail Stephanie.Dumont@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

Enclosures

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 amend Rules 2320(g) and 3110(b) to: (1) require that members executing a customer order in a non-Nasdaq security contact and obtain quotations from three dealers (or all dealers if three or less) to determine the best inter-dealer market for the security, unless two or more priced quotations are displayed in an inter-dealer quotation system that permits quotation updates on a real-time basis (such as the OTC Bulletin Board (“OTCBB”) or the electronic pink sheets); (2) require that members that display priced quotations for the same non-Nasdaq security in two or more quotation mediums that permit quotation updates on a real-time basis display the same priced quotations for the security in each quotation medium; (3) no longer require that a member indicate on the order ticket for each transaction in a non-Nasdaq security the name of each broker/dealer contacted and the quotations received if two or more priced quotations are displayed and NASD Regulation has access, on a historical basis, to the quotation data; and (4) define the terms “inter-dealer quotation system” and “quotation medium” for the purposes of the proposed rule change.

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

2320. Best Execution and Interpositioning

(a) through (f) No Change.

(g)(1) Unless two or more priced quotations for a non-Nasdaq security (as defined in the Rule 6700 Series) are displayed in an inter-dealer quotation system that permits quotation updates on a real-time basis, [I]n any transaction for or with a customer pertaining to the execution of an order in a non-Nasdaq security [(as defined in the Rule 6700 Series)], a member or person associated with a member, shall contact and obtain quotations from three dealers (or all dealers if three or less) to determine the best inter-dealer market for the subject security.

(2) Members that display priced quotations on a real-time basis for a non-Nasdaq security in two or more quotation mediums that permit quotation updates on a real-time basis must display the same priced quotations for the security in each medium.

(3) For purposes of this paragraph, the term “inter-dealer quotation system” means any system of general circulation to brokers or dealers that regularly disseminates quotations of identified brokers or dealers.

(4) For purposes of this paragraph, the term “quotation medium” means any inter-dealer quotation system or any publication or electronic communications network or other device that is used by brokers or dealers to make known to others their interest in transactions in any security, including offers to buy or sell at a stated price or otherwise, or invitations of offers to buy or sell.

(5) Pursuant to the Rule 9600 Series, the staff, for good cause shown, after taking into consideration all relevant factors, may exempt any transaction or classes of transactions, either

unconditionally or on specified terms, from any or all of the provisions of this paragraph if it determines that such exemption is consistent with the purpose of this Rule, the protection of investors, and the public interest.

* * *

3110. Books and Records

(a) No Change

(b)(1) No Change

(b)(2) A person associated with a member shall indicate on the memorandum for each transaction in a non-Nasdaq security, as that term is defined in the Rule 6700 Series, the name of each dealer contacted and the quotations received to determine the best inter-dealer market; however, the requirements of this subparagraph shall not apply if two or more priced quotations for the security are displayed in an inter-dealer quotation system, as defined in Rule 2320(g), that permits quotation updates on a real-time basis for which NASD Regulation has access to historical quotation information.

* * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The proposed rule change was approved by the Board of Directors of NASD Regulation at its meeting on March 29, 2000, which authorized the filing of the proposed 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. The NASD Board of Governors had an opportunity to review the proposed rule change at its meeting on March 30, 2000. 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 amendments to NASD Rules without recourse to the membership for approval.

The NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be 30 days following publication of the Notice to Members announcing Commission approval.

(b) Questions regarding this rule filing may be directed to Stephanie M. Dumont, Assistant General Counsel, NASD Regulation, Office of General Counsel, at (202) 728-8176.

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

(a) Purpose

Rule 2320(g) (the “Three Quote Rule”) was originally adopted on May 2, 1988,¹ as an amendment to the NASD’s best execution interpretation. Specifically, the Three Quote Rule requires members that execute transactions in non-Nasdaq securities on behalf of customers to contact a minimum of three dealers (or all dealers if three or fewer) and obtain quotations in determining the best inter-dealer market.² The intent of the Three Quote Rule is to create a standard to help ensure that members fulfill their best execution responsibilities to customers in non-Nasdaq securities, particularly in transactions involving relatively illiquid securities with non-transparent prices. The Three Quote Rule is a

¹ See Exchange Act Release No. 25637 (May 2, 1988).

² If three firm quotations are displayed, a broker/dealer is not required to call the three market makers to verify the firm quotations that are displayed on the screen. A broker/dealer need only note on the order ticket the identity of the broker/dealers and the firm quotations displayed.

minimum standard, and compliance with the rule, in and of itself, does not mean a member has met its best execution obligations. Best execution requires each member to use reasonable diligence to ascertain the best inter-dealer market for a security, and to buy or sell in that market so that the resultant price to the customer is as favorable as possible under prevailing market conditions.³

Since the adoption of the Three Quote Rule, the market for non-Nasdaq securities has changed dramatically. For example, from 1996 to 1999, the OTCBB has experienced growth of 72% in market maker positions, 421% in average daily share volume, and 65% in average daily dollar volume.

Given the rapid growth in the market for non-Nasdaq securities, NASD Regulation believes that the current Three Quote Rule often hinders, rather than furthers, investor protection by causing significant delays in obtaining executions of customer orders. The costs associated with delayed executions resulting from compliance with the Three Quote Rule are not outweighed by the benefits of obtaining three telephone quotes. Indeed, NASD Regulation believes that the informational value of three telephone quotes is significantly less than the informational value of two transparent, firm quotes in terms of obtaining best execution for customers.

Therefore, NASD Regulation is proposing that Rule 2320(g) be amended to require members to obtain quotations from three dealers (or all dealers if three or less) only when there are fewer than two priced quotations displayed in an inter-dealer quotation system that permits quotation updates on a real-time basis (such as the OTCBB or the electronic pink sheets). The proposed rule change defines the term “inter-dealer quotation system” as any system of general circulation to brokers or dealers that regularly disseminates quotations of identified brokers or dealers. For purposes of the proposed rule change, an inter-dealer quotation system would not include an electronic communications network.

³ See NASD Rule 2320(a).

NASD Regulation believes the proposed rule change will enhance investor protection by reducing execution delays, while improving the quality of information relied upon by firms in seeking to obtain best execution. As with the current rule, the proposed rule change would not limit or change a member's general best execution obligations.

The proposed rule change also would require members that display priced quotations for the same security in two or more quotation mediums that permit quotation updates on a real-time basis to display the same priced quotations in each system. The proposed rule change defines the term "quotation medium" as any inter-dealer quotation system or any publication or electronic communications network or other device that is used by brokers or dealers to make known to others their interest in transactions in any security, including offers to buy or sell at a stated price or otherwise, or invitations of offers to buy or sell.

NASD Regulation believes that members' displaying different priced quotations in different quotation mediums for the same security can be confusing and misleading to other market participants and, more importantly, to public investors. Moreover, requiring that members display consistent priced quotations in multiple quotation mediums will enhance the ability of other market participants to ascertain the best inter-dealer market for a security.

In addition, Rule 3110(b)(2) currently requires that members indicate on the order ticket for each transaction in a non-Nasdaq security the name of each dealer contacted and the quotations received to determine the best inter-dealer market. Under the proposed rule change, members would not be required to note such information on the order ticket if two or more priced quotations are displayed and NASD Regulation has access to the quotation data. As a result, the proposed rule change would alleviate certain recordkeeping burdens for members where NASD Regulation can

validate and confirm compliance with applicable requirements directly through its internal historical data. Currently, NASD Regulation has such data with respect to the OTCBB securities, however, it does not have access to historical quotation data for the electronic pink sheets.⁴

(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 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 change will reduce the time and effort necessary in contacting three market makers when there are at least two priced quotations displayed, while potentially enabling members to provide customers better executions in non-Nasdaq securities than is provided under existing requirements.

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

NASD Regulation does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.

⁴ NASD Regulation currently is soliciting comment on a rule proposal that would require members to record and report their quotation data in the electronic pink sheets or similar quotation systems to NASD Regulation. See NASD Notice to Members 00-17 (March 2000).

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

Not applicable.

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: April 13, 2000

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-NASD-00-20)

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Amendments to Rule 2320(g) and Rule 3110(b)

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. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

NASD Regulation is proposing to amend Rules 2320(g) and 3110(b) of the National Association of Securities Dealers, Inc. (“NASD” or “Association”) to: (1) require that members executing a customer order in a non-Nasdaq security contact and obtain quotations from three dealers (or all dealers if three or less) to determine the best inter-dealer market for the security, unless two or more priced quotations are displayed in an inter-dealer quotation system that permits quotation updates on a real-time basis (such as the OTC Bulletin Board (“OTCBB”) or the electronic pink sheets); (2) require that members that display priced quotations for the same non-Nasdaq security in two or more

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

quotation mediums that permit quotation updates on a real-time basis display the same priced quotations for the security in each quotation medium; (3) no longer require that a member indicate on the order ticket for each transaction in a non-Nasdaq security the name of each broker/dealer contacted and the quotations received if two or more priced quotations are displayed and NASD Regulation has access, on a historical basis, to the quotation data; and (4) define the terms “inter-dealer quotation system” and “quotation medium” for the purposes of the proposed rule change.

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

2320. Best Execution and Interpositioning

(a) through (f) No Change.

(g)(1) Unless two or more priced quotations for a non-Nasdaq security (as defined in the Rule 6700 Series) are displayed in an inter-dealer quotation system that permits quotation updates on a real-time basis, [I]in any transaction for or with a customer pertaining to the execution of an order in a non-Nasdaq security [(as defined in the Rule 6700 Series)], a member or person associated with a member, shall contact and obtain quotations from three dealers (or all dealers if three or less) to determine the best inter-dealer market for the subject security.

(2) Members that display priced quotations on a real-time basis for a non-Nasdaq security in two or more quotation mediums that permit quotation updates on a real-time basis must display the same priced quotations for the security in each medium.

(3) For purposes of this paragraph, the term “inter-dealer quotation system” means any system of general circulation to brokers or dealers that regularly disseminates quotations of identified brokers or dealers.

(4) For purposes of this paragraph, the term “quotation medium” means any inter-dealer quotation system or any publication or electronic communications network or other device that is used by brokers or dealers to make known to others their interest in transactions in any security, including offers to buy or sell at a stated price or otherwise, or invitations of offers to buy or sell.

(5) Pursuant to the Rule 9600 Series, the staff, for good cause shown, after taking into consideration all relevant factors, may exempt any transaction or classes of transactions, either unconditionally or on specified terms, from any or all of the provisions of this paragraph if it determines that such exemption is consistent with the purpose of this Rule, the protection of investors, and the public interest.

* * *

3110. Books and Records

(a) No Change

(b)(1) No Change

(b)(2) A person associated with a member shall indicate on the memorandum for each transaction in a non-Nasdaq security, as that term is defined in the Rule 6700 Series, the name of each dealer contacted and the quotations received to determine the best inter-dealer market; however, the requirements of this subparagraph shall not apply if two or more priced quotations for the security are

displayed in an inter-dealer quotation system, as defined in Rule 2320(g), that permits quotation updates on a real-time basis for which NASD Regulation has access to historical quotation information.

* * *

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

Rule 2320(g) (the “Three Quote Rule”) was originally adopted on May 2, 1988,³ as an amendment to the NASD’s best execution interpretation. Specifically, the Three Quote Rule requires members that execute transactions in non-Nasdaq securities on behalf of customers to contact a minimum of three dealers (or all dealers if three or fewer) and obtain quotations in determining the best inter-dealer market.⁴ The intent of the Three Quote Rule is to create a standard to help ensure that members fulfill their best execution responsibilities to customers in non-Nasdaq securities, particularly in transactions involving relatively illiquid securities with non-transparent prices. The Three Quote Rule is a

³ See Exchange Act Release No. 25637 (May 2, 1988).

⁴ If three firm quotations are displayed, a broker/dealer is not required to call the three market makers to verify the firm quotations that are displayed on the screen. A broker/dealer need only note on the order ticket the identity of the broker/dealers and the firm quotations displayed.

minimum standard, and compliance with the rule, in and of itself, does not mean a member has met its best execution obligations. Best execution requires each member to use reasonable diligence to ascertain the best inter-dealer market for a security, and to buy or sell in that market so that the resultant price to the customer is as favorable as possible under prevailing market conditions.⁵

Since the adoption of the Three Quote Rule, the market for non-Nasdaq securities has changed dramatically. For example, from 1996 to 1999, the OTCBB has experienced growth of 72% in market maker positions, 421% in average daily share volume, and 65% in average daily dollar volume.

Given the rapid growth in the market for non-Nasdaq securities, NASD Regulation believes that the current Three Quote Rule often hinders, rather than furthers, investor protection by causing significant delays in obtaining executions of customer orders. The costs associated with delayed executions resulting from compliance with the Three Quote Rule are not outweighed by the benefits of obtaining three telephone quotes. Indeed, NASD Regulation believes that the informational value of three telephone quotes is significantly less than the informational value of two transparent, firm quotes in terms of obtaining best execution for customers.

Therefore, NASD Regulation is proposing that Rule 2320(g) be amended to require members to obtain quotations from three dealers (or all dealers if three or less) only when there are fewer than two priced quotations displayed in an inter-dealer quotation system that permits quotation updates on a real-time basis (such as the OTCBB or the electronic pink sheets). The proposed rule change defines the term “inter-dealer quotation system” as any system of general circulation to brokers or dealers that regularly disseminates quotations of identified brokers or dealers. For purposes of the proposed rule change, an inter-dealer quotation system would not include an electronic communications network.

⁵ See NASD Rule 2320(a).

NASD Regulation believes the proposed rule change will enhance investor protection by reducing execution delays, while improving the quality of information relied upon by firms in seeking to obtain best execution. As with the current rule, the proposed rule change would not limit or change a member's general best execution obligations.

The proposed rule change also would require members that display priced quotations for the same security in two or more quotation mediums that permit quotation updates on a real-time basis to display the same priced quotations in each system. The proposed rule change defines the term "quotation medium" as any inter-dealer quotation system or any publication or electronic communications network or other device that is used by brokers or dealers to make known to others their interest in transactions in any security, including offers to buy or sell at a stated price or otherwise, or invitations of offers to buy or sell.

NASD Regulation believes that members' displaying different priced quotations in different quotation mediums for the same security can be confusing and misleading to other market participants and, more importantly, to public investors. Moreover, requiring that members display consistent priced quotations in multiple quotation mediums will enhance the ability of other market participants to ascertain the best inter-dealer market for a security.

In addition, Rule 3110(b)(2) currently requires that members indicate on the order ticket for each transaction in a non-Nasdaq security the name of each dealer contacted and the quotations received to determine the best inter-dealer market. Under the proposed rule change, members would not be required to note such information on the order ticket if two or more priced quotations are displayed and NASD Regulation has access to the quotation data. As a result, the proposed rule change would alleviate certain recordkeeping burdens for members where NASD Regulation can

validate and confirm compliance with applicable requirements directly through its internal historical data. Currently, NASD Regulation has such data with respect to the OTCBB securities, however, it does not have access to historical quotation data for the electronic pink sheets.⁶

(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 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 change will reduce the time and effort necessary in contacting three market makers when there are at least two priced quotations displayed, while potentially enabling members to provide customers better executions in non-Nasdaq securities than is provided under existing requirements.

(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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer

⁶ NASD Regulation currently is soliciting comment on a rule proposal that would require members to record and report their quotation data in the electronic pink sheets or similar quotation systems to NASD Regulation. See NASD Notice to Members 00-17 (March 2000).

period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- A. by order approve such proposed rule change, or
- B. institute proceedings to determine whether the proposed rule change should be disapproved.

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].

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

Jonathan G. Katz
Secretary