SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–50678; File No. SR–NASD–2004–156]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by National Association of Securities Dealers, Inc. Related to ECN Response Time Measurement in the Nasdaq Market Center

November 16, 2004.

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 November 3, 2004, the National Association of Securities Dealers, Inc. (''NASD''), through its subsidiary, The Nasdaq Stock Market, Inc. (''Nasdaq''), filed with the Securities and Exchange Commission (''Commission'') the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq. 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 the Substance of the Proposed Rule Change

Nasdaq proposes to change NASD Rule 4710 pertaining to the measurement of Electronic Communication Network (''ECN'') response times and will provide ECNs participating in the Nasdaq Market Center the option to receive and respond to order match delivery traffic using a direct, dedicated point-to-point communication linkage.[3] The text of the proposed rule change is below. Proposed new language is in italics.

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4710. Participant Obligations in the Nasdaq Market Center

(a) No Change.

(b) Non-Directed Orders

(1) General Provisions—A Quoting Market Participant in a Nasdaq Market Center eligible security, as well as Order Entry Firms, shall be subject to the following requirements for Non-Directed Orders:

(A)–(B) No Change.

(C) Decrementation Procedures—The size of a Quote/Order displayed in the order display service and/or the quotation montage of the Nasdaq Market Center will be decremented upon the delivery of a Liability Order or the delivery of an execution of a Non-Directed Order or Preferenced Order in an amount equal to the system-delivered order or execution.

(i) through (iii) No Change.

(iv) If a Nasdaq ECN regularly fails to meet a 5-second response time (as measured by the ECN's Service Delivery Platform *if linked to the Nasdaq Market Center by an application programming interface; or as measured by timestamps generated by the Nasdaq Market Center if linked to the system by a direct connection*) over a period of orders, such that the failure endangers the maintenance of a fair and orderly market, Nasdaq will place that ECN's quote in a closed-quote state. Nasdaq will lift the closed-quote state when the Nasdaq ECN certifies that it can meet the 5-second response time requirement with regularity sufficient to maintain a fair and orderly market.

(v) No Change.

(D) No Change.

(2)–(8) No Change.

(c) through (e) No Change.

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

In its filing with the Commission, Nasdaq 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. Nasdaq 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

1. Purpose

ECNs have two options when participating in the Nasdaq Market Center. They can be ''Auto-Ex'' ECNs, in which case their quotes/orders are subject to automatic execution, or they can elect to be ''Order-Delivery,'' where the system instead delivers a buy or sell trading message to the ECN that, in response, either executes or rejects the message. Today, all ECNs in the Nasdaq Market Center participate as order-delivery ECNs.

Under current Nasdaq Market Center rules, order-delivery ECNs must respond to messages sent to them by the system within 5 seconds on average, and in no event later than 30 seconds for any one message. The 5-second average response standard is measured by timestamps generated by the ECN's Service Delivery Platform (''SDP'') at the ECN's trading location. In this filing, Nasdaq is proposing the adoption of an alternative method to measure the 5-second response time for ECNs that voluntarily elect to link to Nasdaq using a direct, dedicated point-to-point communication linkage to receive and respond to order matches delivered to them.[4] Since use of the dedicated linkage obviates the need for the SDP to process order match and response traffic, Nasdaq proposes to measure directly-linked ECN response times using data generated by the Nasdaq Market Center's host computers. In short, Nasdaq will calculate and monitor, on a real-time basis, the difference between two time stamps: (1) The time the Nasdaq Market Center host dispatched a message to the ECN, and (2) the time the Nasdaq Market Center received a response back from the ECN. On an ongoing basis, Nasdaq will monitor individual directly-linked ECN response times and provide those ECNs with its own order responsiveness time statistics, which will not be made public. As before, if an ECN regularly fails to meet the 5-second response time over a number of orders, Nasdaq will place that ECN's quote in a closed quote state and the closed quote state will be lifted when the ECN can certify that it can meet the 5-second response time requirement.

By providing ECNs the option to use a dedicated linkage, Nasdaq expects to significantly reduce response delays that can be encountered in the current environment where order delivery messages directed to ECNs use existing Nasdaq Market Center application programming interfaces (''APIs'') to reach their destination and are commingled, and compete with, other Nasdaq Market Center messaging (executions, cancels, etc.) for bandwidth to reach the ECN's SDP. All messaging other than ECN match order delivery and response traffic (*e.g.*, quote updates/order deliveries, cancels, and executions

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] Pursuant to a telephone conversation on November 15, 2004, between Thomas Moran, Associate General Counsel, Nasdaq, and Marc McKayle, Special Counsel, Division of Market Regulation (''Division''), Commission, the above language was changed to clarify that an ECN's use of the direct, dedicated point-to-point communication linkage is voluntary under the proposed rule change.

[4] This proposed rule change replaces File No. SR–NASD–2004–66, which was published for comment, and subsequently withdrawn. *See respectively*, Securities Exchange Act Release No. 49604 (April 22, 2004), 69 FR 54818 (April 30, 2004), and Letter from Edward S. Knight, Executive Vice President, Nasdaq to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated October 15, 2004.

reports) will continue to flow between Nasdaq and ECNs using existing communications linkages.[5] As such, ECNs electing to use a dedicated linkage will be required, for the foreseeable future, to maintain the current linkage infrastructure as well as support the new dedicated match order delivery and response linkage.[6]

2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of section 15A of the Act,[7] in general and with section 15A(b)(6) of the Act,[8] in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, remove impediments to a free and open market and a national market system, and, in general, to protect investors and the public interest.

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

Nasdaq 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 has been designated by Nasdaq as a ''non-controversial'' rule change pursuant to section 19(b)(3)(A) of the Act[9] and subparagraph (f)(6) of Rule 19b–4 thereunder.[10]

The foregoing rule change: (1) Does not significantly affect the protection of investors or the public interest, (2) does not impose any significant burden on competition, and (3) by its terms does not become operative for 30 days after the date of this filing, or such shorter time as the Commission may designate, if consistent with the protection of investors and the public interest. Nasdaq has requested that the Commission waive the 30-day pre-operative period and the five-day pre-filing notice requirement for ''non-controversial'' proposals, based on the following representations: (1) The instant proposal is substantively similar to File No. SR–NASD–2004–66, which was published for comment,[11] (2) this proposal simply establishes a means for ECNs to link directly with Nasdaq in order to measure the 5-second response time obligation that ECNs are currently subject to, (3) Nasdaq will conduct the calculation process for policing the 5-second standard for directly-linked ECNs and this proposal will not impose any specific programming burdens on ECNs, and (4) the use of a dedicated linkage by an ECN will be purely voluntary. In light of the foregoing, and because the Commission believes that the proposal should assist Nasdaq's ability to oversee and monitor the quality of its market, the Commission believes that waiver of the 5-day pre-filing requirement and 30-day operative delay is consistent with the protection of investors and the public interest. Accordingly, the Commission has determined to waive the pre-filing requirement and the operative delay.

Consequently, the proposed rule change has become effective pursuant to section 19(b)(3)(A) of the Act,[12] and Rule 19b–4(f)(6) thereunder,[13] with no operative delay.[14]

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change 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, including whether the proposed rule change, as amended, is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/sro.shtml*); or
- Send an e-mail to *rule-comments@sec.gov*. Please include File Number SR–NASD–2004–156 on the subject line.

Paper Comments

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609.

All submissions should refer to File Number SR–NASD–2004–156. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/sro.shtml*). 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 Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR–NASD–2004–156 and should be submitted on or before December 14, 2004.

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[5] While all of this data is important, it is in the area of Match Order delivery and response traffic where delays can have the most negative impact on market participants as a whole since they are the basis for the swift execution of trades between order-delivery ECNs and those seeking to interact with them. Thus, it is on this messaging that Nasdaq's proposed rule change is initially focused.

[6] Nasdaq notes that the above linkage only speeds delivery and receipt of match delivery and response messages between the Nasdaq Market Center host computers and the directly-linked ECN, it would not give such traffic any special priority in the Nasdaq Market Center execution process. Nasdaq believes that its approach will enhance the speed and efficiency of the Nasdaq Market Center system as a whole and can provide a more accurate understanding of whether Nasdaq or an ECN's own internal system is at fault when ECN order processing is unduly delayed.

[7] 15 U.S.C. 78*o*–3.

[8] 15 U.S.C. 78*o*–3(b)(6).

[9] 15 U.S.C. 78s(b)(1).

[10] 17 CFR 240.19b–4(f)(6).

[11] *See supra* note 4.

[12] 15 U.S.C. 78s(b)(1).

[13] 17 CFR 240.19b–4(f)(6).

[14] Nasdaq will provide market participants with notice of the exact date of the implementation of the proposed rule change via a Head Trader Alert on *http://www.nasdaqtrader.com*. Corresponding changes and footnote added pursuant to telephone conversation between Thomas Moran, Associate General Counsel, Nasdaq, and Marc McKayle, Special Counsel, Division, Commission, on November 16, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[15]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. E4–3300 Filed 11–22–04; 8:45 am]

BILLING CODE 8010–01–P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–50683; File No. SR–NASD–2004–107]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Change Relating to Computer Generated Quoting in Exchange-Listed Securities

November 17, 2004.

I. Introduction

On July 12, 2004, the National Association of Securities Dealers, Inc. (''NASD''), through its subsidiary, The Nasdaq Stock Market, Inc. (''Nasdaq''), filed with the Securities and Exchange Commission (''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'') [1] and Rule 19b–4 thereunder,[2] a proposed rule change to allow market makers to engage in Computer Generated Quoting (''CGQ'') in exchange-listed securities. The proposed rule change was published for comment in the **Federal Register** on October 12, 2004.[3] The Commission received no comment letters on the proposal. This order approves the proposed rule change.

II. Description of the Proposal

Nasdaq proposed to eliminate NASD Rule 6330(d), which governs CGQ in exchange-listed securities. NASD Rule 6330(d) prohibits the practice of automatically, and without cognizable human intervention, updating a market maker's quote to keep the market maker away from the inside market. NASD Rule 6330(d)(2) however, contains exceptions to the general prohibition in CGQ, including exceptions for conduct that is consistent with the Commission's Order Handling Rules, and for CGQ that equals or improves either or both sides of the national best bid or offer (''NBBO'') or adds size to the NBBO.

The limitations contained in NASD Rule 6330(d) were originally implemented because of capacity constraints that Nasdaq has stated no longer persist. Under procedures implemented by the Consolidated Tape Association,[4] Nasdaq, as well as any other Participant, now has the opportunity to request additional capacity to accommodate increased quoting, while bearing the expense. Under the proposal, market makers would be able to engage in CGQ without limitations.

III. Discussion and Commission Findings

In the past, the Commission has recognized concerns regarding the accessibility of CGQ and the impact of such quoting on system capacity.[5] Nasdaq has assured the Commission that these capacity constraints no longer persist, since it is now able to request additional capacity in order to accommodate increased quoting. Thus the Commission believes that lifting the current restrictions on CGQ in exchange-listed securities should not cause a significant impact upon system capacity and data traffic. Furthermore, the Commission notes that various markets have moved towards automated systems to make their markets more efficient.[6]

In addition, the Commission notes that permitting automated generation of quotations will likely contribute to more accurate and informative quotations because market makers are able to use automated measures to produce accessible quotations that add value to the market without limitation. Permitting the use of CGQ by market makers allows them to utilize technology to fulfill their quotation obligations efficiently. Moreover, allowing market makers to utilize technology in this manner reduces any competitive disadvantage that the previous auto-quote ban may have created, with the potential to benefit investors by improving liquidity, transparency, and order interaction in the Nasdaq Market Center.

Section 8(d)(ii) of the Intermarket Trading System (''ITS'') Plan governs the adoption and implementation of trade-through rules by ITS Participants. In February 2000, the Commission granted NASD an exemption from the provisions of the ITS Plan relating to automated quote generation by market makers trading non-Rule 19c–3 and Rule 19c–3 securities,[7] thus allowing market makers to engage in CGQ in exchange-listed securities, under particular circumstances. The Commission has extended the exemption annually since December 2000.[8] In granting the exemption, the Commission determined that the exemption was consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets and the removal of impediments to, and the perfection of the mechanisms of, a national market system because it allowed market makers to continue to participate in the market for non-Rule 19c–3 securities and to compete for order flow in Rule 19c–3 securities. The Commission is not aware of any negative effects from the use of computer generated quotations by Nasdaq market makers during the nearly four year period covered by the Commission's exemption.

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with the provisions of section 15A of the Act [9] in general, and section 15A(b)(6) of the Act,[10] which requires that the rules of the NASD foster cooperation and coordination with persons engaged in facilitating transactions in securities and remove impediments to and perfect the mechanism of a free and open market.

IV. Conclusion

It is therefore ordered, Pursuant to section 19(b)(2) of the Act [11] the proposed rule change (SR–NASD–2004–107) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[12]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. E4–3301 Filed 11–22–04; 8:45 am]

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[15] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 50478 (September 30, 2004), 69 FR 60692.

[4] *See* Securities Exchange Act Release No. 47030 (December 18, 2002), 67 FR 78832 (December 26, 2002).

[5] *See* Securities Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290 (September 12, 1996) (''Order Execution Obligations'').

[6] *See* Securities Exchange Act Release No. 49749 (February 26, 2004), 69 FR 11126 (March 9, 2004) (''Proposed Regulation NMS'').

[7] *See* Letter to Eugene A. Lopez, Senior Vice President, Nasdaq, from Robert L.D. Colby, Deputy Director, Division of Market Regulation (''Division''), Commission, dated February 11, 2000.

[8] *See* Letters to Eugene A. Lopez, Senior Vice President, Nasdaq, from Robert L.D. Colby, Deputy Director, Division, Commission dated December 22, 2000, and December 21, 2001; Letter to Eugene A. Lopez, Senior Vice President, Nasdaq, from Alden S. Adkins, Associate Director, Division, Commission, December 31, 2002; and Letter to Eugene A. Lopez, Executive Vice President, Nasdaq, from David S. Shillman, Associate Director, Division, Commission, dated December 23, 2003.

[9] 15 U.S.C. 78*o*–3.

[10] 15 U.S.C. 78*o*–3(b)(6).

[11] 15 U.S.C. 78s(b)(2).

[12] 17 CFR 200.30–3(a)(12).