



National Association of Securities Dealers, Inc.
 1735 K St., N.W. • Washington, D.C. 20006 • (202) 728-8000

notice to members 84-24

May 3, 1984

TO: All NASD Members and Municipal Securities Bank Dealers

ATTN: All Operations Personnel

RE: Memorial Day Trade Date-Settlement Date Schedule

Securities markets and the NASDAQ System will be closed on Monday, May 28, 1984, in observance of Memorial Day. "Regular Way" transactions made on the business days noted below will be subject to the following schedule.

Trade Date-Settlement Date Schedule
For "Regular-Way" Transactions

<u>Trade Date</u>		<u>Settlement Date</u>		<u>Regulation T Date*</u>	
May	21	May	29	May	31
	22		30	June	1
	23		31		4
	24	June	1		5
	25		4		6
	28	Markets Closed			—
	29		5		7

The foregoing settlement dates should be used by brokers, dealers and municipal securities dealers for purposes of clearing and settling transactions pursuant to the Association's Uniform Practice Code and Municipal Securities Rulemaking Board Rule G-12 on Uniform Practice.

Questions regarding the application of these settlement dates to a particular situation may be directed to the Uniform Practice Department of the NASD at (212) 839-6256.

* Pursuant to Section 4(c)(2) of Regulation T of the Federal Reserve Board, a broker-dealer must promptly cancel or otherwise liquidate a customer purchase transaction in a cash account if full payment is not received within seven (7) business days of the date of purchase or, pursuant to Section 4(c)(6), make application to extend the time period specified. The date by which members must take such action is shown in the column entitled "Regulation T Date."

NASD

National Association of Securities Dealers, Inc.
1735 K St., N.W. • Washington, D.C. 20006 • (202) 728-8000

notice to members 84-25

May 3, 1984

TO: All NASD Members and Other Interested Persons

RE: Quarterly Checklist of Notices to Members

Following is a list of NASD Notices to Members issued during the first quarter of 1984. Requests for copies of any notice should be accompanied by a self-addressed label and may be directed to: NASD Administrative Services, 1735 K Street, N.W., Washington, D. C. 20006.

Notice Number	Date	Topic
84-1	January 9, 1984	National Market System to Expand to 728 Issues January 17; and Year-End NASDAQ Market Highlights
84-2	January 13, 1984	12 Securities Mandated Into NMS on February 17
84-3	January 24, 1984	Temporary Relief From Certain Provisions of Rules 15c-3-1 and 15c3-3 Dealing With Registered Municipal Securities Is Extended Until March 31, 1984, By SEC Staff
84-4	January 23, 1984	National Market System Grows to 789 Securities with 50 Additions on February 14
84-5	January 25, 1984	SIPC Trustee Appointed for Jay W. Kaufmann & Co., New York
84-6	January 25, 1984	Temporary Regulations Under The Interest and Dividend Tax Compliance Act of 1983; Back-Up Withholding

84-7	January 30, 1984	SEC Staff Interpretations of Rule 15c2-4
84-8	February 3, 1984	Temporary Receiver Appointed For Southeast Securities of Florida, Hoboken, New Jersey
84-9	February 3, 1984	SIPC Trustee Appointed for California Municipal Investors, Inc., Los Angeles, California
84-10	February 3, 1984	Holiday Settlement Schedule - February 1984
84-11	February 3, 1984	SIPC Trustee Appointed for Gattini & Co., New York, New York
84-12	February 8, 1984	Quarterly Checklist of Notices to Members
84-13	February 10, 1984	PLATO Learning Center ShutDown March 3-11; Extensions of Qualification Examination Expiration Dates
84-14	February 15, 1984	SIPC Trustee Appointed for Southeast Securities of Florida, Inc., Hoboken, New Jersey
84-15	February 28, 1984	National Market System Grows to 834 Securities with 50 Additions on March 20
84-16	March 1, 1984	Revised Rates for TARS
84-17	March 13, 1984	Mail Vote - Amendment to Association's Rules of Fair Practice
84-18	March 16, 1984	Holiday Settlement Schedule - April 1984
84-19	March 16, 1984	SIPC Trustee Appointed for MV Securities, Inc., New York, New York
84-20	March 28, 1984	National Market System Grows to 881 Securities with 50 Additions on April 17

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NASD

National Association of Securities Dealers, Inc.
1735 K St., N.W. • Washington, D.C. 20006 • (202) 728-8000

notice to members 84-26

May 11, 1984

TO: All NASD Members and Other Interested Persons

RE: Request for Comment on Proposed Criteria for NASDAQ NMS Designation

On April 30, 1984, the Securities and Exchange Commission ("SEC" or "Commission") published for comment changes to the National Market System (NMS) designation criteria which by the National Association of Securities Dealers, Inc. ("Association" or "NASD") has proposed. If adopted, the effect of the changes would be to expand significantly the number of companies eligible for inclusion in NMS. Comments on this proposal should be submitted to the SEC no later than June 15, 1984. The Commission's release as published in the May 7th edition of the Federal Register is attached for your reference. To assist you in your review of this material, the background and summary of the NASD's proposal are discussed below.

BACKGROUND

The NASDAQ National Market System commenced operation on April 1, 1982, with the initial designation of 40 securities into NMS. Transactions in securities which are traded in this new environment are subject to last-sale trade reporting by market makers within 90 seconds of execution. Since the start-up of NMS, additional securities have been added according to a timetable specified in the NASD's National Market System Designation Plan. To date, 880 securities have been added to NMS and an additional 100 securities are scheduled for addition during the next few months. By the end of June, approximately 82% of the securities qualified for NMS will have been added to the system.

When the SEC adopted the NMS designation criteria, it established a two-tiered system of requirements wherein certain very actively traded securities would be mandatorily added to NMS (Tier 1 securities) and lesser active securities would be added voluntarily (Tier 2 securities). In addition to basic financial tests, the Tier 1 criteria include a four market maker test, a \$10 price test, and a volume test of 600,000 shares a month for a six-month period. Since Tier 1 securities are mandatorily added to NMS, any NASDAQ company which meets these tests is

automatically designated for inclusion in the National Market System. While the Tier 2 criteria includes the same basic financial and market maker tests as Tier 1, the price test is \$5 and the volume requirement is significantly less at 100,000 shares a month for a six-month period. Since Tier 2 additions are voluntary — companies meeting the criteria must submit an application for designation prior to their addition to NMS.

The NASD's proposal would amend the voluntary criteria to permit the continued expansion of NMS through the addition of qualified companies from the NASDAQ National Newspaper List. On February 10, 1984, the NASD petitioned the SEC to amend the NMS designation criteria by replacing certain market activity tests with financial criteria. The result of the change would be an expansion from approximately 1,200 to 2,500 in the number of securities eligible for trading in the NMS.

During the two years of operation of the National Market System, the SEC and the NASD have continuously monitored the trading activity in NMS securities and both have found that last-sale reporting has benefited the markets in these securities. Also, prior to the full-scale expansion of NMS through the addition of Tier 2 securities, a major study was conducted during February, March and April of 1983, of a limited pilot program. The purpose of this study was to determine whether NMS designation had adverse effects on the markets for Tier 2 NMS securities. The findings of the study were analyzed by the NASD's Board of Governors, its various standing committees, and various securities industry representatives and organizations, and the staff of the SEC. The study determined that NMS designation had no noticeable effect on the price performance or the volatility of prices for securities added to the National Market System.

In addition to the special study, during the last two years the NASD Board and three standing committees (the Trading Committee, the NMS Securities Qualifications Committee and the Corporate Advisory Board) have met frequently to review activity in the National Market System and develop enhancements to facilitate trade reporting. A few observations of note are that last-sale reporting has been beneficial to the issuers of NMS designated securities, their shareholders, and members of the investment community. We have also observed that last-sale information has also provided both increased information upon which to make investment decisions as well as increased exposure to designated securities.

Based on the favorable findings with respect to NMS designation, the NASD's Board of Governors, at the recommendations of the Trading Committee, the NMS Securities Qualifications Committee, and the Corporate Advisory Board, filed the recently proposed criteria for NMS designation with the SEC. The new criteria would extend the benefit of last-sale reporting to all Section 12(g) registered companies qualified for the NASD's National Newspaper List.

DISCUSSION OF THE NASD'S PROPOSAL

Today there are nearly 1,800 securities in the National Newspaper List which is published daily in over 100 newspapers throughout the world. In addition, the NASDAQ National Market System List is published in even more newspapers so that over 2,700 NASDAQ securities are now receiving publication of market activity information.

The criteria that are proposed by the NASD would permit companies to qualify for NMS if they meet the National Newspaper List criteria which include two alternative sets of requirements. Both proposed alternatives for NMS would require that a company be registered pursuant to Section 12(g), have at least \$2 million in total assets, 300 shareholders, and two market makers. In addition, the first alternative requires that the issue have a \$3 price and a public float of 350,000 shares valued at \$2 million, while the company must have \$1 million in capital and surplus and \$300,000 net income in the latest year or in two of the three last fiscal years. The second alternative proposed for NMS inclusion is for companies operating without a net income. The second alternative requires that the issue have a public float of 800,000 shares valued at \$8 million and the company has a capital and surplus of \$8 million with an operating history of four years.

With respect to transaction reporting obligations associated with trading NMS securities, the NASD has enhanced the NASDAQ System to ease the burden on broker-dealers. Specifically, the NASD developed a computer-to-computer interface (CTCI) which permits firms to meet NMS trade reporting obligations by entering trade details through their in-house computer system which is, in turn, transmitted by computer to the NASDAQ System. In December of this year, the NASD's Small Order Execution System (SOES) will be operational. This system will permit firms to execute trades in NMS securities up to 300 shares directly through their NASDAQ terminals. Since trades will be executed directly through the NASDAQ System, there is no need to report the details of the transactions through the terminal. It is estimated that up to one-half of all NMS trades could be executed through SOES which would significantly reduce a firm's burden resulting from trade reporting. Finally, the NASD has been working with the National Security Traders Association (NSTA) on a proposal which would permit bunching of trade reports under certain circumstances. The bunching of trade reports reduces the total number of required trade reports without losing the necessary pricing volume information.

Based on the system enhancements and the revision to the mechanics of trade-reporting, the Board does not feel that an expansion of the number of NMS eligible securities will significantly increase the burden of trade reporting.

REQUEST FOR COMMENT

In the Commission's release, the SEC accurately states that the NASD has proposed eligibility criteria for the NASDAQ National Market System identical to those of the National Newspaper List. However, the Commission staff has raised three questions for consideration regarding this proposal which the NASD finds troublesome and upon which it urges you to address your comments. Their questions and the Association's views are as follows:

Minimum Bid Price

- Should a minimum price standard, such as the present \$5 minimum bid price, continue to be a part of NMS criteria? According to the SEC, the issues here are whether NMS designation may be used by issuers of low priced "hot issue" stocks to achieve extra prominence, and whether low priced speculative stocks are suitable for NMS designation.

Comments — In point of fact, Alternative #1 under the NASD's proposal prescribes a minimum bid price of \$3 per share and that requirement is coupled with other criteria including a net income test of \$300,000 and a market value requirement of \$2,000,000. It is only as to Alternative #2 under the NASD's proposal that a minimum bid price is not prescribed. However, to qualify under this alternative, a company would have to have, among other things, a capital and surplus of \$8,000,000, a public float of 800,000 and an operating history of at least 4 years. Designed mainly for developing companies of substance, this alternative is based primarily on issuer characteristics and not trading markets, a practice long observed by the stock exchanges in setting their listing standards. In fact, several of the regional exchanges do not have a minimum price test as a qualification for exchange listing. In addition, the financial criteria of the National Newspaper List and the proposed National Market System are significantly higher than those prescribed in the listing standards of the various regional exchanges. Also, the second of the two alternative listing tests of the American Stock Exchange, for reasons paralleling those of the NASD, similarly prescribes no minimum price requirement. Related to this point is the fact that all of the exchanges currently have numerous securities that trade at prices below \$5 per share.

It is the Association's opinion that the principal benefit of national market system designation — namely, last-sale reporting and thus investor access to basic price information — should be equally available to both exchange-traded securities and competitive dealer-traded NASDAQ securities. The Board therefore believes that no NASDAQ security, otherwise qualified, should be prohibited from entry into NMS due to a failure to exceed some arbitrary price standard. A capital and surplus test of \$8,000,000 coupled with the other prescribed criteria will insure that only the shares of companies of high quality will be admitted to trading in NMS.

Minimum Trading Volume

- Should the minimum volume standard be eliminated, as proposed by the NASD, or should a lower volume standard, such as 50,000 a month for six months, be adopted, to insure that all NMS stocks are actively traded?

Comments — As noted above, the NASD once used volume based criteria as the principal criterion for qualifying stocks for its National Newspaper List. Experience proved this criterion to be unsatisfactory because it ignored the more important underlying characteristics of the issuer company. It also left the composition of such list to the changing whims of investors and the impact of current investment fads and fashions. As a consequence, the list was very unstable. Investors became puzzled by the fact that the periodic revisions to the list resulted in massive additions and deletions. It was very difficult for even the most knowledgeable of investors to keep track of what companies were in and which companies were out of the list. Many companies of substance, including many large banks, insurance companies and major financial institutions were excluded from the list and investor information about his securities holdings in these companies was simply unavailable. This all changed when the NASD replaced its National Newspaper List volume-based criteria with basic financial criteria. The list quickly stabilized. Companies of substance and quality, though possibly less actively traded, were once again included in the list and investor response was very positive. This experience, coupled with the fact that no other market center prescribes a minimum volume test of any kind as a condition to listing, strongly

suggests to the Association that a volume standard is an inappropriate criterion for entry into the National Market System.

Number of Market Makers

- Would a reduction of the required number of competing market makers from 4 to 2, as proposed by the NASD, result in securities included in NMS which do not have sufficient nationwide investor interest and trading activity?

Comments — The fact that a company has fewer than four market makers does not necessarily mean that the company is not a nationally recognized name, does not have a nationwide investor following or, is inactively traded. There are a significant number of National Newspaper List companies that have less than four (but at least two) market makers whose volume exceeds 50,000 shares per month. In many of these cases, it is the industry or the underlying characteristics of the issuer that cause the economic optimum in terms of the number of market makers to be either 2 or 3. This does not mean that these markets are any less liquid or lacking in depth. Competition between dealers, firm quotes and NASD market surveillance work together to insure the existence of quality markets. Indeed, many of the companies which have 2 or 3 market makers are sizable companies with strong investor followings. Furthermore, although small in number, the broker-dealers which typically make these markets are broker-dealers having considerable size, good business reputes and significant financial strength. If anything, the quality of the markets made rather than the number of markets made is the more important factor. Since the quality of the market is more a function of market maker qualifications and surveillance, it is the NASD's view that any requirement beyond a two market maker test is unnecessary and perhaps inconsistent with a scheme of regulation that should be designed to let market forces determine the proper equilibrium for market maker participation.

* * *

Power to finalize the NASDAQ National Market System criteria proposed by the NASD rests with the Securities and Exchange Commission and, as part of their decision-making process, the SEC has requested your comments. The NASD's Board of Governors strongly urges you to make your comments on this subject known to the SEC. Your ideas and opinions are extremely important and the nature of your comments will substantially affect the final SEC decision in this matter.

Your comments to the SEC should reference File No. S7-787 and be directed to:

George A. Fitzsimmons, Secretary
Securities and Exchange Commission
450 Fifth Street, N. W.
Washington, D. C. 20549

If you have questions concerning the proposal that you would like answered before writing the SEC, please feel free to call Glenn C. Faulkner, Assistant Director, NASDAQ Company Services, at (202) 728-8275.

Finally, it would be very helpful to the Board if you would provide us with a copy of your comment letter to the SEC. It may be sent to:

Glenn C. Faulkner, Assistant Director
National Association of Securities Dealers, Inc.
1735 K Street, N. W.
Washington, D. C. 20006

Once again, your participation in this rulemaking process is extremely important. Whether you agree or disagree with the NASD's views on this proposal, it is vital that you communicate your thinking to the SEC. Only by so doing can you be assured that your voice will be heard.

Thank you.

Sincerely,



Gordon S. Macklin
President

Enclosure

Monday
May 7, 1984

Federal Register

**SECURITIES AND EXCHANGE
COMMISSION**

17 CFR Part 240

[Release No. 34-20902; File No. S7-787]

**Designation on National Market
System Securities**

AGENCY: Securities and Exchange
Commission.

ACTION: Proposed rule amendments and
solicitation of public comments.

SUMMARY: In response to a petition
submitted by the National Association
of Securities Dealers, Inc., the
Commission is proposing amendments
to its rule governing the designation of
securities qualified for trading in a
national market system. The primary
effect of these amendments would be to
increase substantially the number of
securities that would be eligible for
designation as national market system
securities.

DATE: Comments to be received by June
15, 1984.

ADDRESSES: All comments should be
submitted in triplicate and addressed to
George A. Fitzsimmons, Secretary,
Securities and Exchange Commission,
450 Fifth Street NW., Washington, D.C.
20549. All comments should refer to
File No. S7-787, and will be available for
public inspection at the Commission's
Public Reference Room, 450 Fifth Street,
NW., Washington, D.C.

FOR FURTHER INFORMATION CONTACT:
Andrew E. Feldman, (202) 272-2388,
Room 5190, Division of Market
Regulation, Securities and Exchange
Commission, 450 Fifth Street, NW.,
Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION:

Summary

The Securities and Exchange
Commission ("Commission") today
proposed amendments to Rule 11Aa2-1
("Rule")¹ under the Securities Exchange
Act of 1934 ("Act"),² which establishes

procedures by which certain securities
are designated as qualified for trading in
a national market system ("NMS
Securities"). This action is in response
to a recent petition by the National
Association of Securities Dealers, Inc.
("NASD") requesting that the
Commission expand the Rule's
qualification standards to the level of its
National List standards, thus making a
total of approximately 2500 securities
eligible for NMS designation. The
principal effects of NMS designation are
that designated securities are subject to
last-sale reporting and firm quote
requirements. The Commission has
monitored trading in NMS Securities
carefully and believes that last sale
reporting has benefited the over-the-
counter ("OTC") markets for those
securities; the Commission also
preliminarily believes that a substantial
expansion of the NMS criteria may be
appropriate. The standards proposed by
the NASD are discussed in detail below
and summarized in a chart included as
Exhibit A. In addition to the broad issue
of the expansion of the number of
securities eligible for NMS designation,
the Commission requests comment, as
discussed more fully below, regarding
the importance of the Rule's current
minimum net price, market maker, and
trading volume requirements.

I. Background

Section 11A(a)(2) of the Act directs
the Commission "to facilitate the
establishment of a national market
system," and empowers the Commission
to designate by rule "the securities or
classes of securities qualified for trading
in the national market system."
Although the Act does not specify which
securities should be included in a

¹ 17 CFR § 240.11Aa2-1. See Securities Exchange
Act Release No. 17549 (February 17, 1981), 46 FR
13992 ("Rule 11Aa2-1 Adoption Release").

² 15 U.S.C. §§ 78a *et seq.*, as amended by the
Securities Acts Amendments of 1975 ("1975
Amendments"), Pub. L. No. 94-29 (June 4, 1975), 89
Stat. 97, [1975] U.S. Code Cong. & Ad. News 97.

national market system, the legislative history indicates that the Commission should evaluate characteristics of a security such as "trading volume, price, and number of stockholders" in determining whether a security should be designated as an NMS Security.³

On February 17, 1981, the Commission adopted the Rule to provide the criteria and procedures by which certain securities traded exclusively in the OTC market were to be designated as NMS Securities.⁴ The Rule employs a two-tiered approach toward NMS designation that is predicated upon the characteristics of certain OTC securities for which quotation information is disseminated in the NASD's electronic interdealer quotation system ("NASDAQ"),⁵ Tier 1, which became effective on April 1, 1982, requires that the most actively traded OTC securities be designated as NMS Securities.⁶ Tier

2, which became effective on February 1, 1983, permits certain additional actively traded OTC securities to become NMS designated at the election of the issuer.⁷ Under the less stringent Tier 2 criteria, a far larger group of OTC securities are eligible for designation.⁸ The primary effect of designating OTC stocks as NMS Securities at the present time is to require that transactions in such securities be reported in a real-time system in accordance with the Commission's last sale reporting rule,⁹ and that quotations for such securities be firm as to the quoted price and size in accordance with the Commission's firm quotation rule.¹⁰ In adopting the Rule, the Commission determined, among other things, that real-time transaction reporting and firm quotations would increase market efficiency and enhance opportunities for public investors to obtain best execution of their orders.¹¹

On October 1, 1981, the Commission published for public comment¹² a petition, submitted by the NASD, to relax substantially the Tier 2 designation criteria to allow more issuers of OTC securities to elect NMS status.¹³

On January 7, 1982, the Commission deferred final action on the NASD's 1981 petition to expand the criteria for Tier 2 designation.¹⁴ The Commission stated

⁷ 17 CFR § 240.11Aa2-1(b)(4)(ii). The current Tier 2 criteria for NMS designation require that the issuer have net tangible assets of at least \$2,000,000 and capital and surplus of at least \$1,000,000. In addition, there must be at least 250,000 publicly owned shares and the market value of the publicly-held shares must be at least \$3,000,000. Furthermore, the price per share must be \$5 or more, the average trading volume per month must total 100,000 shares, and there must be at least four NASDAQ market makers in the security.

⁸ There currently are approximately 236 Tier 1 NMS Securities and 645 Tier 2 NMS Securities. An additional 294 OTC securities are eligible for designation under the present NMS Tier 2 criteria.

⁹ 17 CFR § 240.11Aa3-1.

¹⁰ 17 CFR § 240.11Ac1-1.

¹¹ See Rule 11Aa2-1 Adoption Release, *supra* note 1, 46 FR at 13993.

¹² See Securities Exchange Act Release No. 18131 (October 1, 1981), 46 FR 49594 ("1981 Petition Proposal Release").

¹³ Specifically, the NASD proposed two alternative sets of Tier 2 criteria that it claimed were based generally on the listing standards of the American Stock Exchange, Inc. ("Amex"). One set of criteria would cover relatively smaller companies that had a history of earnings, while the other set of criteria would cover relatively larger companies that had a substantial operating history, although their recent operations may not have been profitable. The NASD estimated that a total of approximately 800 additional OTC securities would be eligible for designation under these standards at that time. Letter from S. William Broka, Secretary, NASD, to George A. Fitzsimmons, Secretary, SEC (July 24, 1981) ("1981 NASD Proposal"). (The NASD estimates that approximately 500 additional securities would be eligible under these standards now.)

¹⁴ Securities Exchange Act Release No. 18397 (January 7, 1982), 47 FR 2079 ("Deferral Release").

that the deferral would help provide an orderly phase-in of Tier 2 securities, and would provide an opportunity to study the effects of transaction reporting on existing NMS Securities before making a final determination on whether to expand the universe of eligible securities.¹⁵

Also on January 7, 1982, the Commission approved the NASD's "National Market System Securities Designation Plan with Respect to NASDAQ Securities" ("Designation Plan") which had been filed pursuant to the Rule.¹⁶ Accordingly, the NASD designated the first Tier 1 NMS Securities on April 1, 1982.

In response to concerns raised by market makers about the onset of last sale reporting in numerous Tier 2 securities at one time, on December 1, 1982, the Commission approved an amendment to the Designation Plan to provide for the phasing in of those securities meeting the Tier 2 voluntary designation criteria.¹⁷ The phase-in feature of the Designation Plan provided for the designation of 100 eligible securities per month, and for a suspension in designation between February 8, 1983, and April 29, 1983, while the NASD studied the impact of last sale reporting on the markets for NMS Securities as well as the ability of the NASDAQ system to accommodate the reporting of additional NMS Securities.¹⁸

The NASD's study concluded that NMS designation does not adversely affect market makers or issuers of NMS Securities. Specifically, the NASD's study determined that last sale reporting had no adverse impact on quotation spreads and intraday price volatility after securities became NMS designated, that NMS designation was a factor in increasing NASDAQ volume, and there had been no appreciable decline in market maker participation in NMS Securities. Nonetheless, the NASD recommended a reduction of the number of monthly Tier 2 designations in order to reduce the impact on market makers of increasing numbers of OTC securities

¹⁵ *Id.*, 47 FR at 2082.

¹⁶ Securities Exchange Act Release No. 18399 (January 7, 1982), 47 FR 2226. The NASD's Designation Plan generally provides procedures for designating NMS Securities, determining substantial compliance with the designation criteria, and publishing lists of designated securities. The plan also establishes maintenance criteria for NMS Securities, and criteria for terminating or suspending the designation of NMS Securities.

¹⁷ Securities Exchange Act Release No. 19286 (December 1, 1982), 47 FR 55357.

¹⁸ *Id.*

³ Senate Comm. on Banking, Housing & Urb. Affs., *Report to Accompany S. 249: Securities Acts Amendments of 1975*, S. Rep. No. 94-75, 94th Cong., 1st Sess. 7 (Comm. Print 1975) ("Senate Report"), reprinted in, [1975] U.S. Code Cong. & Ad. News 179, 185.

⁴ For more extensive discussion of the background of Rule 11Aa2-1, see Securities Exchange Act Release No. 15926, (June 15, 1979), at 2-13, 44 FR 36912, 36912-14 ("Rule 11Aa2-1 Proposal Release").

⁵ Although the Rule defines a national market system security as "any equity security which is designated as qualified for trading in a national market system," the current two-tier approach makes only NASDAQ securities eligible for designation. The Rule, moreover, provides for the removal of the NMS designation "[i]f such security becomes listed and registered, or admitted to unlisted trading privileges, on an exchange." 17 CFR § 240.11Aa2-a(a), (b).

In adopting the Rule, the Commission concluded that imposing NMS qualification criteria upon listed securities was unnecessary at that time because most listed securities already were included in national market system last sale and quotation disclosure facilities, and selection of less than all reported securities as NMS Securities could create unwarranted distinctions among these securities. Nonetheless, the Commission specifically left open whether exchange traded securities should be designated as NMS Securities in the future. See Rule 11Aa2-1 Adoption Release, *supra* note 1, 46 FR at 13994, 95. In view of the proposed substantial expansion of the class of OTC securities eligible for NMS designation, the Commission requests comment on whether exchange traded securities should now be designated as NMS Securities, and, in particular, whether the proposed OTC standards should be applied in similar fashion to exchange trade securities, or whether some other classification criteria, such as stock traded through the Intermarket Trading System, should be established.

¹⁷ 17 CFR § 240.11Aa2-1(b)(4)(i). The current Tier 1 criteria for mandatory NMS designation require that the issuer of the NASDAQ security must have net tangible assets of at least \$2,000,000 and capital and surplus of at least \$1,000,000. In addition, there must be at least 500,000 publicly owned shares of stock outstanding, and the market value of the publicly-held shares must total at least \$5,000,000. Furthermore, the price per share must be \$10 or more, the average trading volume per month must be at least 600,000 shares, and there must be at least four NASDAQ market makers in the security.

becoming subject to last sale reporting in a short period of time.¹⁹

On May 20, 1983, the Commission approved the NASD's proposed modification of the phase-in procedures of the Designation Plan.²⁰ The amendment reduced the number of eligible securities to be designated per month from 100 to 50. The Commission found that the amendment was a reasonable method of minimizing reporting burdens while enabling the NASD to continue to phase-in new NMS designation.²¹

II. The NASD's Petition

On February 10, 1984, the NASD again petitioned the Commission to amend the Rule to increase the number of securities eligible for voluntary designation as NMS Securities.²² In its petition, the NASD asserted that in the two years since the Commission deferred final action on the NASD's 1981 petition,²³ the "NASDAQ/National Market System has move from concept to reality." The NASD stated that 727 NASDAQ securities has been designated pursuant to the Rule as of February 1, 1984, and another 149 securities would be designated as NMS Securities in the next three months. As a result, over seventy percent of the approximately 1200 NASDAQ securities eligible for designation under the current Tier 1 and Tier 2 criteria would be designated by the end of April, 1984.²⁴

The NASD's petition also affirmed the findings of the NASD's February 8-April 29, 1983 NMS Securities study, which found that last sale reporting did not have a detrimental impact on the markets for NMS Securities.²⁵ In

particular, the NASD's petition indicated that market makers have not found last sale reporting as burdensome as they had initially feared, and that the NASD has not observed any major decrease in market making or liquidity in NMS Securities.²⁶ Based on these observations and their discussions with traders, issuers, and institutions, the NASD generally concluded that last sale reporting has benefited the issuers of NMS Securities, their shareholders, and members of the investment community, through providing additional information for investment decisions and greater exposure for designated securities.

In light of its conclusions concerning the benefits of last sale reporting, the NASD reexamined its earlier proposal regarding Tier 2 criteria, and concluded that the Tier 2 criteria should be extended to provide the benefits of last sale reporting to OTC securities eligible for the NASDAQ National List.²⁷ Accordingly, the NASD's petition proposed that the two alternative criteria currently used for inclusion in the NASDAQ National List be used as the Tier 2 designation criteria.²⁸

¹⁹ In a separate letter providing further information on the trading experience of NMS Securities, the NASD said that the sixteen NMS Securities with the lowest trading volume in December, 1983 had lost an average of .88 market makers since the start of last sale reporting. The NASD noted, however, that all sixteen companies underwent a considerable decline in volume after they qualified for the NMS, and that in these conditions both NMS and non-NMS Securities tend to lose market makers. Letter from John T. Wall, Executive Vice President, NASD, to Brandon Becker, Assistant Director, SEC (February 10, 1984) ("NASD February 1984 Letter").

²⁷ For purposes of providing the media with information on NASDAQ securities, the NASD identifies a "National List" of major issues trading in NASDAQ, and an "Additional List" of other active NASDAQ securities. The National List, determined primarily on the basis of issuer financial criteria, as described below, currently contains approximately 1,788 issues; the Additional List, determined on the basis of dollar trading volume, contains another 1,000 issues. In November 1980, the NASD adopted the present National List criteria, reflecting issuer quality, in place of its previous dollar trading volume criteria, to reduce the List's focus on high trading volume and to include more major NASDAQ companies with substantial assets but only moderate trading activity. See, *The NASDAQ Securities Fact Book*, 1981.

²⁸ The NASD also recently requested the Board of Governors of the Federal Reserve System ("Federal Reserve Board") to amend its margin regulations to give automatic marginability to securities on its National List. For OTC securities to be eligible for margin at present, they must appear on the Federal Reserve's OTC Margin List. The Federal Reserve recently proposed amendments to its regulations that would give automatic marginability only to NMS Securities. Federal Reserve Docket R-0512, 49 FR 9741.

The NASD stated that, on average, the companies that meet the NASD's proposed criteria but that do not qualify as NMS Securities under the present Tier 2 criteria have significant financial strength and shareholder interest.²⁹ The NASD also asserted that, as the number of NMS Securities increases, many newspapers will tend to save space by dropping the NASDAQ National List and only publishing information concerning NMS Securities.³⁰ As a result, the NASD argued that many investors in National List securities that are ineligible for NMS designation would lose their primary source of price information for these securities, and the companies themselves would lose exposure. Consequently, the NASD concluded that unless the NMS criteria were expanded, non-NMS National List companies would be pressured to list on an exchange and seek inclusion in the Consolidated Tape³¹ in order to maintain their present level of visibility.

In this connection, the NASD reiterated its position, expressed in its former petition for expansion of the Tier 2 criteria, that many OTC securities denied NMS designation would qualify for exchange listing on the basis of "substantial compliance" with exchange listing standards,³² and would obtain the benefits of last sale reporting in this manner, to the OTC market's disadvantage. The NASD emphasized that the present Tier 2 volume standards appear especially stringent when compared to the trading experience of many exchange-listed stocks. In particular, the NASD noted that many

²⁹ The NASD states that, as of January 27, 1984, the typical company meeting the National List criteria but not the present Tier 2 criteria had an average price of \$13 3/4, an average number of publicly-held shares of 2,414,388, an average market value of these shares of \$38,499,634, and average net income of \$3,591,862. See NASD February 1984 Letter, *supra* note 26, at 7.

³⁰ The NASD noted that at present only the *Wall Street Journal* carries the NASD's full "Additional List," and only two other newspapers carry the "Additional List" in part.

³¹ The Consolidated Tape, operated by the Consolidated Tape Association ("CTA"), compiles current last sale reports in listed securities from all exchanges and market makers trading the securities and disseminates these reports to vendors on a consolidated basis. The CTA is composed of the New York ("NYSE"), Amex, Boston, Cincinnati, Midwest, Pacific and Philadelphia Stock Exchanges, and the NASD. The NASD argued that National List companies would qualify for inclusion in the Consolidated Tape either by satisfying the CTA inclusion criteria directly or on the basis of a determination by one of the exchanges that the security "substantially complied" with the CTA's inclusion standards.

³² Most exchange listing standards permit the exchange to list securities that do not satisfy completely the exchange's explicit listing standards if these securities are deemed to be in "substantial compliance" with those standards.

¹⁹ See Securities Exchange Act Release No. 19797 (May 20, 1983), 48 FR 24823.

²⁰ *Id.*

²¹ *Id.*

²² Letter from S. William Broka, Secretary, NASD, to George A. Fitzsimmons, Secretary, SEC, (February 10, 1984).

²³ For a discussion of the NASD's 1981 petition, see *supra* notes 12-15 and accompanying text.

²⁴ The number of present and proposed NMS Securities are as follows:

Present NMS Securities: Tier 1-238, Tier 2-645/
Total = 881.

Additional NMS Securities as of May 31, 1984: 44/
Total = 925.

NMS eligible securities that have not elected designation: 250/Total NMS-eligible securities: 1,175.

Total National List (excluding NMS): 1,788.

Total National List securities presently ineligible for NMS: 1,444.

National List securities NMS-eligible under the NASD's current proposal: 1,300-1,350.

National List securities not eligible under NASD's proposal: 94-144.

Total NMS-eligible securities under NASD's proposal: 2,475-2,525.

²⁵ For a discussion of the NASD's 1983 study, see, text accompanying notes 18-19, *supra*.

stocks currently trading on the Amex would not satisfy the present Tier 2 trading volume requirement of 100,000 shares a month.³³

The NASD further asserted that the market characteristic standards currently part of the Rule's Tier 2 criteria, such as minimum price per share and monthly trading volume, are unnecessary to ensure that only appropriate securities are designated as NMS Securities. The NASD claimed that the issuer's ability to choose, based on advice from its market makers and investment bankers, whether to have its security designated under the Tier 2 NMS standards generally will prevent securities unlikely to benefit from last sale reporting from being designated as NMS Securities.³⁴

The NASD's petition proposed two alternative sets of Tier 2 criteria, identical to the National Lists' present criteria. The first alternative criteria, applicable to newer companies with substantial net income but less extensive assets, would require that the issuer have net income in the previous fiscal year, or in two of the last three fiscal years, of \$300,000, and at least 350,000 publicly held shares with a market value of \$2,000,000. This alternative also would require a minimum bid price per share of \$3 and a minimum of two NASDAQ market makers in the stock for five business days prior to the application date.

The NASD's second alternative criteria, applicable to longer-established companies with substantial assets but low net income, would require that the issuer have operated for four years, have capital and surplus of \$8,000,000, and have at least 800,000 publicly held shares with a market value of \$8,000,000. This second alternative also would require a minimum of two NASDAQ market makers for five business days before the application date, but would impose no minimum price per share requirement.

The NASD also proposes for both alternatives an accompanying reduction in the Designation Plan's maintenance standards for continued NMS

³³ See Letter from John T. Wall, Executive Vice President, NASD, to Richard Ketchum, Associated Director SEC, (March 13, 1984). It should be noted, however, that in both exchange and OTC markets, including the NMS Securities markets, securities often fall below the initial listing standards after they become listed, and yet are only removed if they fail to meet the market's ongoing maintenance standards.

³⁴ However, if the issuer's designation decision is based primarily on the greater exposure obtained as an NMS Company, it is possible that an issuer may elect NMS designation even though the markets for its securities may not benefit from last sale reporting.

designation. The NASD proposes to reduce the maintenance standard's market maker requirement from three to two, and to eliminate the present \$1,000,000 annual dollar trading volume requirement.

III. Discussion

When the Rule was initially adopted, the Commission employed restrictive criteria for designation of OTC securities as NMS Securities, at least partly in response to the serious concerns expressed by commentators regarding the potential impact of last sales reporting on the OTC market. In both its proposal and its deferral of the NASD's initial petition for extension of the Tier 2 standards, however, the Commission indicated its belief that an expansion of the Tier 2 criteria might be desirable,³⁵ if there were no significant problems with last sale reporting the NMS Securities designated under existing standards.

A. *Reporting Procedures.* As the NASD emphasized in its current petition, it appears that the phase-in of last sale reporting for Tier 2 NMS Securities has taken place smoothly, without significant disruption of the markets, impaired liquidity, or reduction in market maker participation in NMS Securities.³⁶ Moreover, the NASD has indicated that its surveillance of OTC trade reporting and inspections of market makers have not shown any significant problems with the quality of NMS trade reporting generally. The NASD also has indicated that the OTC traders represented on its various committees now strongly support extension of last sale reporting to additional OTC securities. In contrast, the previous NASD petition to expand the Tier 2 criteria, submitted before any experience with OTC last sale reporting had been obtained, was strongly opposed by the OTC market maker community.³⁷

³⁵ See 1981 Petition Proposal Release, *supra* note 12, at 3, 46 FR 49594; Deferral Release, *supra* note 14, at 5, 47 FR at 2060.

³⁶ As the NASD pointed out in its February 1984 Letter, the phase-in of last sale reporting in Tier 2 securities over the past months was eased by the recent slowdown in general OTC market activity, and the lower level of trading volume in the most recently designated Tier 2 securities. See NASD February 1984 Letter, *supra* note 26, at 3.

³⁷ In general, OTC market makers commenting on the previous NASD petition expressed concern that OTC last sale reporting would raise the clerical costs of market making, and would reduce the liquidity of the OTC market for large blocks of stocks. These market makers argued that real-time reporting of large traders would notify competing market makers when a position was taken, possibly resulting in changes in the market price, thus increasing the risk of the market maker making the trade. See Deferral Release, *supra* note 14, at 8; 47 FR at 2081.

The concerns expressed formerly by OTC market makers regarding the possibility of reduced liquidity from last sale reporting do not appear to have materialized. Moreover, the reporting by market makers of trades in NMS Securities appears to have been generally accurate in nature. Nonetheless, the Commission believes that improvement is needed in certain aspects of the last sale reporting process. In particular, it appears that the last sale reporting during peak volume periods, such as the first and last hours of trading, may be somewhat less accurate and timely than reporting during other times, due to the added pressures on traders during these periods. For further gains in trade reporting quality, reduced reliance on reporting by traders appears necessary.

The press of reporting by traders during peak volume periods may be reduced by greater use by market maker firms of existing automation facilities, and development of additional systems. For instance, the NASD's existing computer-to-computer interface, which allows trade reporting to the NASD directly through clerical input of trade reports into the market maker's internal order handling system, offers an effective means of enhancing trade reporting. Alternatively, additional clerical support could be employed to relieve traders of the task of reporting through NASDAQ terminals. Moreover, the NASD's proposed Small Order Execution System, which will automatically execute and report trades of 300 shares or less at the inside market price, should further aid reporting accuracy. Automatic reporting of a large segment of small orders, which compose a substantial part of all OTC trades, could reduce the burdens on traders and thus significantly improve reporting quality.³⁸

While the Commission recognizes that NMS transaction reporting on the whole has been generally accurate, the Commission believes that additional procedures and systems must be put into place to enhance further the quality of trade reporting during peak periods. Accordingly, the Commission encourages OTC market makers and the NASD to strive for continued improvements in trade reporting.

³⁸ In addition, the Commission understands that the NASD and the National Security Traders Association ("NSTA") are considering proposing changes in the present NASD reporting requirements to allow trade reports executed within 60 seconds to be aggregated up to a total of 9,999 shares and reported at one time, in order to further ease the task of reporting all trades promptly during peak periods.

Notwithstanding the need for further improvements, the Commission believes that trade reporting for NMS Securities has enhanced pricing efficiency and opportunities for improved execution of customer orders. Therefore, in view of the generally positive experience to date with last sale reporting in NMS Securities, the Commission preliminarily believes that a substantial expansion of the range of securities eligible for Tier 2 designation may be appropriate. Accordingly, the Commission, in response to the NASD's petition, is publishing for comment the two alternative Tier 2 criteria proposed by the NASD, which incorporate the NASD's present National List criteria.

B. Revised Designation Criteria. With respect to the NASD's proposed criteria, it should be noted that a National List security only would be designated as an NMS Security at the election of the issuer. Hence, eligible securities would not become subject to the last sale reporting requirements of the Rule if the issuer concluded, possibly based on the advice of its investment bankers and market makers, that the markets for the security would not benefit from last sale reporting. Moreover, the NASD's proposal would not affect the Rule's Tier 1 criteria; the automatic designation of NMS Securities would continue to apply to only the most actively traded and liquid OTC securities.

The Commission notes, however that the criteria proposed by the NASD represent a change in the rationale for Tier 2 standards as well as a reduction in the level of certain of these standards. By dropping Tier 2's present average trading volume requirement for both of its alternatives, and the present price per share requirement for the second of its alternatives, the NASD's proposal focuses primarily on the nature of the issuer rather than on the trading characteristics of the security.

The Commission recognizes that exchange listing standards typically center on issuer characteristics rather than trading market characteristics in determining eligibility for exchange listing.³⁹ Moreover, the Commission recognizes that criteria such as assets, market value, and number of public shareholders often are useful indicators of securities with deep and liquid markets. Nonetheless, trading market standards were included in the Rule to

³⁹ Neither the Amex nor the NYSE sets a minimum trading volume requirement for listing. The Amex, but not the NYSE, impose a minimum price per share listing requirement of \$5; however the Amex will consider listing securities with lower bid price in a variety of situations. See Amex Company Guide § 102(b), NYSE Company Manual § 102.01.

ensure that securities designated under the Rule have the extensive investor following and liquid markets necessary for trading in the broader national market system, as envisaged in Section 11A(a)(2) of the Act.⁴⁰ In the absence of these standards, low priced or inactively traded NASDAQ securities could be designated as NMS Securities and become subject to last sale reporting.

1. Bid Price. The Commission requests comment whether in the absence of trading market standards, NMS designation may be used by issuers of speculative low priced "hot issue" stocks to achieve extra prominence. In particular, the Commission requests comment whether in this way, issuers of speculative stocks could obtain extensive national exposure and use their NMS status to further promote their trading activity.⁴¹ The Commission also questions whether speculative low priced securities should be recognized and promoted as NMS Securities.

The Commission therefore requests comments on whether the low-priced National List securities which would be eligible for NMS designation under the NASD's proposed amendments are suitable for NMS designation.⁴² The Commission also requests comment on the appropriateness of eliminating the minimum price requirement from the Rule's Tier 2 standards. In this connection, the Commission requests commentators to consider whether some minimum price standard, such as the present \$5 minimum bid price, should continue to be part of the Tier 2 standards.

2. Trading Volume. The Commission also requests comment on whether Tier

⁴⁰ The Senate Report on the 1975 Amendments described securities qualified for trading in the national market system in terms of trading characteristics "trading volume, price, and number of stockholders." See Senate Report, *supra* note 3, at 18. Similarly, in the Rule 11Aa2-1 Proposal Release, the Commission emphasized the need for market criteria to ensure that NMS Securities were of national investor interest and would benefit from the enhanced competitive atmosphere resulting from last sale reporting. See, Rule 11Aa2-1 Proposal Release, *supra* note 4, at 4, 44 FR at 36918.

⁴¹ The use of extensive publicity measures, as well as other devices, to promote trading activity in hot issues is discussed in the statement of John S. R. Shad, Chairman, and John M. Fedders, Director, Division of Enforcement, of the SEC, before the Subcommittee on Securities of the Senate Committee on Banking, Housing, and Urban Affairs, (December 15, 1983).

⁴² The Commission notes that data collected by the staff of the Federal Reserve Board in connection with their consideration of automatic marginability for OTC securities indicates that, as of February 21, 1984 83 of the then 1,715 National List stocks had less than a \$5 bid price. See Staff Memorandum from the Division of Supervision and Regulations and the Division of Research and Statistics to the Board of Governors of the Federal Reserve System (February 27, 1984) ("Federal Reserve Memo").

2's minimum trading volume requirement should be eliminated as the NASD proposed. In this connection, the Commission requests comment on whether some lower trading volume standard such as 50,000 shares a month for six months is appropriate to ensure that all NMS Securities are actively traded.⁴³ The Commission also solicits comment on whether a minimum trading volume requirement should be retained in the maintenance requirements of the NASD's Designation Plan in order to remove wholly inactive securities from the list of NMS Securities.

3. Number of Market Makers. Comment is also requested regarding the reduction of the required number of market makers from four to two as proposed by the NASD. In particular, the Commission seeks comment on whether a stock with only two competing market makers demonstrates sufficient nationwide investor interest and trading activity to justify inclusion in the national market system. In this connection, it appears that the securities with only two market makers frequently have substantially wider spreads than securities with four or more market makers.⁴⁴

Furthermore, the Commission notes that the NASD indicated that the securities meeting its proposed standards had an average of six market makers per security. Therefore, the retention of a four market maker standard would not appear to exclude a large proportion of those securities that otherwise satisfy the proposed standards.⁴⁵ In view of these factors, the Commission solicits comment on the difference in the quality of markets for securities with two market makers as compared to those with four market makers, and on whether the four market maker requirement should be reduced as the NASD proposed.

The Commission also solicits comments regarding the impact of last sale reporting on National List Securities not currently eligible for NMS designation. In particular, the Commission solicits comment on whether the adoption of the NASD's

⁴³ The NASD had indicated to the Commission that in the first quarter of 1984 approximately 52% of its present National List securities had trading volume of over 50,000 shares per month.

⁴⁴ The Federal Reserve Memo indicated that of the National List securities with two market makers as of July 13, 1983, over fifty percent had bid/ask spreads in excess of one dollar. See Federal Reserve Memo, *supra* note 42, at 15.

⁴⁵ Data provided by the Federal Reserve Board staff indicate that, as of February 21, 1984, 191 of the 1,715 National List Stocks had less than four market makers. See Federal Reserve Memo, *supra* note 42, at Table 3.

proposed amendments could result in benefits for National List securities designated under the Rule, in terms of increased numbers of market makers, increased liquidity, or reduced spreads. The Commission also requests comment on whether the exclusion of certain National List securities from voluntary NMS designation would result in a reduction in the number of market makers, a decrease in liquidity, or an increase in bid-ask spreads for these securities.

C. Reporting Costs. Finally, the Commission invites OTC market makers and others to comment on the potential impact on the OTC markets of the NASD's proposed expansion of the number of securities eligible for NMS designation. In particular, the Commission requests comment regarding the volume of trades in securities eligible for last sale reporting under the proposed criteria, including estimates of how trading volume in these securities compares to trading volume in present NMS Securities. With respect to this estimated trading volume, comment is solicited regarding the costs imposed on market makers of reporting these additional trades, and whether accommodation of this increase would necessitate major systems or other changes.⁴⁶

IV. Summary of the Initial Regulatory Flexibility Analysis

The Commission has prepared an Initial Regulatory Flexibility Analysis ("IRFA"), pursuant to the requirements of the Regulatory Flexibility Act⁴⁷ regarding the proposed amendments to the Rule 11Aa2-1. The IRFA indicates that the proposed amendments solicit comment on expansion of the number of OTC securities eligible for NMS designation from the present 1,200 to 2,525. The IRFA notes that the principal effect of this expansion would be to require broker-dealers to report trades on a real-time basis in these additional

⁴⁶ The Commission notes that the NASD indicated that, if the Rule were amended, it would consult with the NSTA regarding an appropriate phase-in program for the additional qualifying securities. In this connection, the Commission also solicits comment whether, in the event the universe of Tier 2 securities were expanded in whole or in part as the NASD proposed, the Designation Plan's Tier 2 phase-in procedures should be continued to spread out the number of Tier 2 securities designated at one time and reduce the burden of a sudden increase in reporting obligations for market makers.

⁴⁷ 5 U.S.C. 601 *et seq.*

securities. The IRFA also notes that while last sale reporting in these additional securities could impose costs on broker-dealers of reduced trader efficiency, increased clerical costs, and possibly systems enhancements, these costs may be limited in view of the small incremental trading volume in the additional securities eligible for designation under the proposal, compared to securities designated previously. However, the Commission is soliciting comment on the extent of this reporting volume and the resulting costs for broker-dealers. In addition, the IRFA notes that the proposed amendments may provide off-setting benefits to investors and the markets in terms of increased pricing efficiency and opportunities for improved executions.

A copy of the IRFA may be obtained by contacting Andrew E. Feldman, (202) 272-2388, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, D.C. 20549.

List of Subjects in 17 CFR Part 240

Reporting and recordkeeping requirements, Securities.

V. Statutory Basis and Text of the Amendments

Pursuant to the Securities Exchange Act of 1934 and particularly Section 11A(a)(2) and 23(a) thereof, 15 U.S.C. 78k-1(a)(2) and 78w(a), the Commission proposes to amend § 240.11Aa2-1 in Chapter II of Title 17 of the Code of Federal Regulations, by revising paragraph (b)(2)(i) and amending the first sentence of paragraphs (b)(2)(iii), by revising paragraph (b)(4)(ii) and adding a new paragraph (b)(4)(iii), and by redesignating current paragraph (b)(4)(iii) as (b)(4)(iv), as follows:^{*}

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

§ 240.11Aa2-1 Designation of national market system securities.

(b) *Designation criteria.*

(2) Any NASDAQ security not described in paragraph (b)(1) of this section which

^{*} Note.—Arrows indicate text proposed to be added. Brackets indicate text proposed to be deleted.

(i) Substantially meets the criteria set forth in paragraph (b)(4)(ii) > or (b)(4)(iii) < of this section ("Tier 2 criteria");

(ii) * * *

(iii) Is a warrant to subscribe to a security described in paragraph (b)(1) or (b)(2)(i) of this section and meets the criteria set forth in paragraph (b)(4) [(iii)] > (iv) < of this section ("Warrants") * * *

(3) * * *

(4) * * *

(ii) *Tier 2 Criteria.* >—Alternative 1 <

(A) The issuer of the security [has net tangible assets of at least \$2,000,000 and capital and surplus of at least \$1,000,000] > had annual net income of at least \$300,000 in the most recently completed fiscal year or in two of the last three most recently completed fiscal years. <

(B) There are at least [250,000] > 350,000 < publicly held shares.

(C) The market value of publicly held shares is at least [\$3,000,000] > \$2,000,000. <

(D) The price per share on each of the five business days prior to the date of application by the issuer is [\$5] > \$3 < or more.

[(E) The average volume of trading per month for the six month period preceding the date of application by the issuer is 100,000 shares or more.]

[F] > E < At least [four] > two < dealers act as NASDAQ market makers with respect to the security on each of the five business days preceding the date of application by the issuer.

> (iii) *Tier 2 Criteria.*—Alternative 2

(A) The issuer of the security has capital and surplus of at least \$8,000,000.

(B) There are at least 800,000 publicly held shares.

(C) The market value of publicly held shares is at least \$8,000,000.

(D) At least two dealers act as NASDAQ market makers with respect to the security on each of the five business days preceding the date of application by the issuer.

(E) The issuer has a four year operating history. < [(iii)] > (iv) < *Warrants.*

By the Commission.

George A. Fitzsimmons,
Secretary.

April 30, 1984.

EXHIBIT A

	Current SEC tier 2 criteria	191 NASD proposal for tier 2 criteria		1984 NASD proposal for tier 2 criteria		Maintenance criteria	
		Alternative 1	Alternative 2	Alternative 1	Alternative 2	Current	Proposed
Net tangible assets.....	\$2,000,000	\$4,000,000	\$12,000,000	\$	\$	\$	\$
Capital and surplus.....	\$1,000,000			\$8,000,000	\$8,000,000	*\$1,000,000	*\$1,000,000
Publicly-held shares.....	250,000	400,000	1,000,000	350,000	800,000	200,000	200,000
Market value of publicly-held shares.....	\$3,000,000	\$3,000,000	\$10,000,000	\$2,000,000	\$8,000,000	\$2,000,000	\$2,000,000
Price per share.....	\$5	\$5		\$3			
Average monthly share trading volumes.....	100,000						
Market makers.....	4	4	4	2	2	3	2
Annual net income in the previous fiscal year or in 2 of the last 3 fiscal years.....		\$4,000,000		\$3,000,000		*\$2,000,000	*\$2,000,000
Annual dollar trading volume.....		\$1,000,000	\$1,000,000			\$1,000,000	
Years in operation.....			5		4		

*Either can be met.

[FR Doc. 84-12220 Filed 5-4-84; 8:45 am]

BILLING CODE 8010-01-M

NASD

National Association of Securities Dealers, Inc.
1735 K St., N.W. • Washington, D.C. 20006 • (202) 728-8000

notice to members 84-27

May 15, 1984

IMPORTANT

Officers * Partners * Proprietors

TO: All NASD Members

RE: SEC Request For Comments on NASDAQ Options Proposal
(Comment Period Ends on June 15, 1984)

On April 12, 1984, the SEC issued Release No. 34-20853 requesting public comments on the NASDAQ Options Program. The text of this release, together with a document which provides an overview of the NASDAQ Options Program and a fact sheet highlighting major features of the program, are enclosed with this notice.

The Commission's release also solicits comments on proposals by the Chicago Board Options Exchange and the American, Pacific, Philadelphia and New York Stock Exchanges to trade options on NASDAQ NMS securities.

The SEC's decisions on vital issues raised in the enclosed release will determine whether you, as NASDAQ market makers, will be permitted to trade standardized options on NASDAQ NMS securities in the NASDAQ market or whether these options will be traded on the exchanges.

In sum, the Commission's decisions on important questions raised in the attached release, as influenced by comments received, will determine the future market structure for standardized options trading. Because of the importance of the issues involved, the Board of Governors strongly urges members to comment on the release.

This notice and the enclosed material have been prepared to assist members in reviewing the Commission's release and preparing comments thereon.

Review of the NASDAQ Options Proposal
and SEC Request for Comments

As explained in the enclosed fact sheet and overview, the NASDAQ Options Program will permit the quotation display of standardized put and call options on certain actively traded NASDAQ National Market System ("NMS") securities and certain NASDAQ and NASDAQ NMS indices.

Several new and innovative second generation concepts in options trading are being built into the NASDAQ Options Program. These include a small order execution system and the introduction of facilities for creating "locked-in" trades for purposes of trade reporting, confirmation, comparison and clearance.

The NASD's Board of Governors believes that the NASDAQ Options Program represents a major step forward in the evolution of industry facilities which will provide an options market that is superior to any that is in place today.

Comments on the SEC's Release

The Commission's release solicits comments on many details of the NASDAQ Options Program and members are encouraged to carefully read the Commission's Release and provide their input in this regard.

In addition to these specific comments, the SEC is raising certain threshold issues, resolution of which will shape the future market structure for standardized options trading. These issues, which the Board urges members to comment on, are as follows:

- "Integrated" or "side-by-side" trading in the NASDAQ Options Program.
- Decisions as to which markets will be permitted to trade NASDAQ options.
- The desirability of automatic executions and locked-in trades for options and other advanced features of the NASDAQ Options Program.
- Surveillance requirements for NASDAQ options trading involving both options and underlying securities.

Integrated Trading

The focal point of the Association's proposed program is the ability of members to make markets simultaneously in both options and their underlying securities, i.e., "side-by-side" or "integrated" market making. Integrated market making will be permitted only when there are a minimum of ten market makers in an underlying NASDAQ security and five market makers in its related NASDAQ option. Having carefully studied this issue, the Association's Board has concluded that the ability of firms to make side-by-side markets is not only appropriate but also extremely desirable given the highly competitive nature of the NASDAQ market. In the competitive NASDAQ market, there is little justification for prohibiting members from simultaneously making markets in both stocks and options.

In this regard, an analysis of integrated trading in warrants and underlying equities via NASDAQ has shown to the Board's satisfaction that this practice does not raise undue regulatory concerns and, in fact, may increase market maker participation in both equity and derivative securities markets and may improve the quality of markets for underlying securities. The results of this study on integrated trading in warrants and equities are contained in a document entitled An Analysis of the Economic and Regulatory Issues Relating to Integrated Market Making in Options and Underlying Securities on NASDAQ. This study, which was filed with the SEC on December 22, 1983, may be obtained from the Association upon request.

Because integrated trading will benefit NASDAQ market makers and the NASDAQ market without raising concomitant regulatory concerns, the Board of Governors strongly urges members to support integrated trading in the NASDAQ Options Program in their comments to the SEC on the enclosed Release.

Exchange vs. NASDAQ Trading of Options
on NASDAQ NMS Securities

In addition to requesting comments on the NASDAQ Options Program, the Commission's release also solicits comments on proposals by the Chicago Board Options Exchange and the American, Pacific, Philadelphia and New York Stock Exchanges to trade options on NASDAQ NMS securities.

Current SEC policies do not permit the trading of an options class in more than one market, a practice referred to as "multiple trading." The exchanges' and the NASD's proposals to trade options on NASDAQ NMS securities have caused the Commission to revisit the question of whether it should continue to prohibit multiple trading.

Today, as an alternative to multiple trading, optionable underlying securities are allocated among the exchanges by lottery. Once allocated, options on selected securities become the exclusive franchise of an exchange.

These allocation procedures, if extended to underlying NASDAQ NMS securities which the options exchanges propose to trade, would, in the Board's view, have adverse competitive impacts on the NASDAQ Options Program. Because an extension of the lottery system to options on NASDAQ NMS securities might result in the allocation of NASDAQ options stocks among the exchanges and the NASD, the NASDAQ Options Program might receive an insufficient number of underlying securities to justify the cost of developing options related automated systems.

Of equal concern to the Board and NASDAQ issuers is the fact that under existing allocation procedures, issuers of underlying securities cannot choose whether options should be traded on their stocks nor, if they are, the market in which such options should be traded.

The Board believes that NASDAQ issuers should have the right to determine whether options are traded on their securities and should be able to choose their market of preference.

The Board therefore urges members in their comments to the Commission on the enclosed release to support the position that NASDAQ options should be traded in the NASDAQ market subject to issuer approval and should not be allocated to the exchanges under existing lottery procedures.

NASDAQ Options Systems

The automatic execution system for NASDAQ options ("NOAES") and the locked-in trade feature, ("OCT") will, in the Board's view, greatly increase the efficiency of executions, reconciliation, clearing and surveillance in the NASDAQ options market.

For these reasons, the Board urges members to support the trading systems proposed for the NASDAQ Options Program in their comments on the Commission's release.

Surveillance

In determining whether to move forward with the NASDAQ Options Program, the Board carefully considered the fact that any adverse consequences of stock/options manipulations involving NASDAQ options might far outweigh any benefits flowing to members and the investing public created by options trading.

The locked-in trade features of NOAES and OCT, together with the NASD's ability to capture and retain all quotations entered into the system, will create a complete record of NASDAQ options transactions, permitting the NASD to compare transaction reports with market maker quotation changes to determine if frontrunning and other abuses have occurred.

Another key element of the integrated surveillance system will be an audit trail for equities underlying NASDAQ options which is currently under development.

A document entitled A Discussion of the NASDAQ Options Surveillance Program was filed with the SEC on December 22, 1983, and will be provided to members by the Association upon request.

The Board views integrated stock/options surveillance as an essential ingredient for investor protection under any program which would propose to trade options on NASDAQ securities.

Therefore, the Board asks members in comments on the Commission's release to request that the Commission not approve any proposal to trade NASDAQ options until the NASD's surveillance systems and related equity audit trail are in place.

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Please note that the deadline for comments is June 15, 1984. Letters to the SEC should include reference to File No. SR-NASD 80-10 and should be addressed as follows:

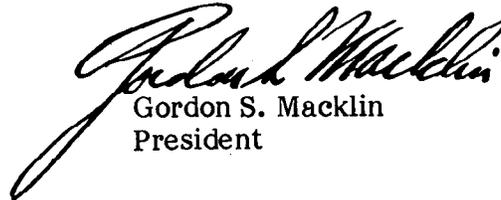
George A. Fitzsimmons, Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

The Association would appreciate receiving copies of letters sent to the Commission. Please address such correspondence to:

Peter T. Canada
Assistant Director, NASDAQ Operations
National Association of Securities Dealers, Inc.
1735 K Street, N.W.
Washington, D.C. 20006

Members who wish to obtain additional materials or information concerning the NASDAQ Options Program or the SEC's release may do so by contacting Mr. Canada at (202) 728-8479.

Sincerely,



Gordon S. Macklin
President

Attachments