

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45777; File No. SR-NASD-2002-26]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto by National Association of Securities Dealers, Inc. Relating to the Adjustment of Open Orders in Nasdaq's SuperMontage System

April 18, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on March 25, 2002, The National Association of Securities Dealers, Inc. ("NASD"), through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq.<sup>3</sup> The NASD filed this proposal under section 19(b)(3)(A) of the Act,<sup>4</sup> and Rule 19b-4(f)(6) thereunder,<sup>5</sup> which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

NASD is proposing to allow the adjustment of open orders residing in SuperMontage in response to issuer corporate actions. Nasdaq will implement this rule change no later than 30 days after successful user acceptance testing of the SuperMontage system. Below is the text of the

proposed rule changes. Proposed new language is underlined.

\* \* \* \* \*

4715. *Adjustment of Open Quotes and/or Orders*—NNMS will automatically adjust the price and/or size of open quotes and/or orders resident in the system in response to issuer corporate actions related to a dividend, payment or distribution, on the ex-date of such actions, except where a cash dividend or distribution is less than one cent (\$0.01), as follows:

(a) *Quotes*—All bid and offer side quotes shall be purged from the system.

(b) *Sell Orders*—Sell side orders shall not be adjusted by the system and must be modified, if desired, by the entering party, except for reverse splits where such sell side orders shall be purged from the system.

(c) *Buy Orders*—Buy side orders shall be adjusted by the system based on the particular corporate action impacting the security (i.e. cash dividend, stock dividend, both, stock split, reverse split) as set forth below:

(1) *Cash Dividends*: Buy side order prices shall be first reduced by the dividend amount and the resulting price will then be rounded down to the nearest penny unless marked "Do Not Reduce".

(2) *Stock Dividends and Stock Splits*: Buy side order prices shall be determined by first rounding up the dollar value of the stock dividend or split to the nearest penny. The resulting amount shall then be subtracted from the price of the buy order. Unless marked "Do Not Increase", the size of the order shall be increased by first, (A) multiplying the size of the original order by the numerator of the ratio of the dividend or split, then (B) dividing that result by the denominator of the ratio of the dividend or split, then (C) rounding that result to the next lowest round-lot.

(3) *Dividends Payable in Either Cash or Securities at the Option of the Stockholder*: Buy side order prices shall be reduced by the dollar value of either the cash or securities, whichever is greater. The dollar value of the cash shall be determined using the formula in paragraph (1) above, while the dollar value of the securities shall be determined using the formula in paragraph (2) above. If the stockholder opts to receive securities, the size of the order shall be increased pursuant to the formula in subparagraph (2) above.

(4) *Combined Cash and Stock Dividends/Split*: In the case of a combined cash dividend and stock split/dividend, the cash dividend portion shall be calculated first as per section (1) above, and stock portion

thereafter pursuant to sections (2) and/or (3) above.

(5) *Reverse Splits*: All orders (buy and sell) shall be cancelled and returned to the entering firm.

(d) *Open buy and sell orders that are adjusted by the system pursuant to the above rules, and that thereafter continuously remain in the system, shall retain the time priority of their original entry.*

\* \* \* \* \*

#### 4705. NNMS Participant Registration

(a) through (f) No Change.

(g) The Association and its subsidiaries shall not be liable for any losses, damages, or other claims arising out of the NNMS or its use. Any losses, damages, or other claims, related to a failure of the NNMS to deliver, display, transmit, execute, compare, submit for clearance and settlement, adjust, retain priority for, or otherwise correctly process an order, Quote/Order, message, or other data entered into, or created by, the NNMS shall be absorbed by the member, or the member sponsoring the customer, that entered the order, Quote/Order, message, or other data into the NNMS.

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#### 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

As part of its ongoing preparation for the launch of SuperMontage, Nasdaq is engaging in a continuing review of the system's functionality and rules with a view to constant improvement. As a result of this review, and in consultation with industry professionals, Nasdaq has determined to adopt rules to govern the adjustment of open orders residing in the SuperMontage system in response to issuer corporate actions (e.g. stock splits, stock dividends).

The current design of SuperMontage contemplates that the open orders of

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> On March 25, 2002, the Commission received an amendment from Nasdaq revising its process for adjusting open orders in Nasdaq's future Order Display and Collection Facility ("NNMS" or "SuperMontage"). See letter from Edward S. Knight, Executive Vice President and General Counsel, Nasdaq, to Katherine England, Assistant Director, Division of Market Regulation ("Division"), Commission, dated March 22, 2002 ("Amendment No. 1"). Amendment No. 1 supersedes and replaces in its entirety the original proposed rule change that Nasdaq filed with the SEC on February 21, 2002. The proposed rule change is treated as filed on the date Amendment No. 1 was received.

<sup>4</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>5</sup> 17 CFR 240.19b-4(f)(6). Nasdaq requested that the Commission waive the 5-day pre-filing notice requirement.

securities residing in the system that thereafter become subject of a corporate action(s) by the issuer impacting their price and/or size are to be cancelled and purged from SuperMontage and returned to the entering party for adjustment and, if desired, re-entry. Once purged, these orders lose their original time-priority in the system and are treated as new orders upon re-entry.

In order to assist Nasdaq market participants that elect to submit orders to SuperMontage in appropriately managing and adjusting such open orders, and the quotes representing such orders, in response to actions taken by an issuer, Nasdaq has determined to adopt an automated process within the system that will govern how open SuperMontage quotes and/or orders will, and will not be adjusted as the result of issuer corporate actions.

First, quotes on both the bid and offer side of the market will be purged by the system if they are for stocks that become subject of a corporate action that impacts their price or size. Once purged, they will have to be re-entered, if desired, by a quoting market participant. Orders to sell will not be purged by the system and will not be automatically adjusted by the system.<sup>6</sup> Buy orders shall have their price and/or size automatically adjusted by the system based on the type of corporate action taken by the issuer as outlined in the rule language. Nasdaq notes that automatic adjustments of open orders proposed here are substantially similar to those already in place for NASD members pursuant to NASD Rule 3220.<sup>7</sup> Finally, orders that are automatically adjusted by the system and that thereafter continuously remain in SuperMontage shall retain the time-priority of their original entry.

Nasdaq believes that adoption of these automated adjustments to open orders will enhance the ability of market participants to manage customer limit orders. By automating the open order adjustment process in the context of corporate actions, firms can ensure that open orders of customers residing in the SuperMontage system will be consistently and appropriately adjusted whenever a corporate action impacts them. Moreover, since adjustments

made by the system result in the order retaining its original time priority, the process decreases firm and customer burdens that can accompany the wholesale purging and re-entry of customer limit orders when an issuer corporate action takes place while retaining, to the extent possible, the time-priority previously established by customers.

Nasdaq proposes to revise its Rule 4705 to provide for the proposed adjustments to be made to SuperMontage orders in connection with the corporate actions described above and the proposed priority retention.<sup>8</sup> In addition, Nasdaq proposes to clarify in its Rule 4705 that Nasdaq shall bear no liability for SuperMontage errors by adding the word "correctly" to such rule.<sup>9</sup>

## 2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with section 15A(b) of the Act,<sup>10</sup> in general, and furthers the objectives of section 15A(b)(6) of the Act,<sup>11</sup> in particular, because it promotes just and equitable principles of trade, fosters cooperation and coordination with persons engaged in processing information with respect to, and facilitating transactions in securities, as well as removes impediments to and perfects the mechanism of a free and open market, and, in general, protects 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.

### *C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others*

Nasdaq has neither solicited nor received written comments.

## III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed 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) does not become operative for 30

days after the date of filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest; provided that Nasdaq has given the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission, the proposed rule change has become effective pursuant to section 19(b)(3)(A) of the Act<sup>12</sup> and Rule 19b-4(f)(6)<sup>13</sup> thereunder.

A proposed rule change filed under Rule 19b-4(f)(6)<sup>14</sup> normally requires that a self-regulatory organization give the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change. However, Rule 19b-4(f)(iii)<sup>15</sup> permits the Commission to designate a shorter time. Nasdaq seeks to have the five-business-day pre-filing requirement waived with respect to the proposed rule change. The Commission has determined to waive the five-business-day pre-filing requirement.

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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. 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

<sup>6</sup> The only exception to this standard is sell orders involving a security subject to a reverse stock split. Such sell orders shall be purged by the system and must be re-entered, if desired, by the entering party.

<sup>7</sup> Unlike NASD Rule 3220, the proposal does not specifically address the adjustment of open stop orders to buy or sell because SuperMontage will not accept stop orders. Telephone call between Thomas P. Moran, Counsel, Nasdaq, and Jennifer Lewis, Attorney, Division, Commission, on April 5, 2002 ("April 5 Telephone Call").

<sup>8</sup> April 5 Telephone Call, *supra* note 7.

<sup>9</sup> *Id.* Nasdaq believes that the rule language already provided for this waiver of liability, but that the rule language could be improved.

<sup>10</sup> 15 U.S.C. 78o-3(b).

<sup>11</sup> 15 U.S.C. 78o-3(b)(6).

<sup>12</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>13</sup> 17 CFR 240.19b-4(f)(6).

<sup>14</sup> *Id.*

<sup>15</sup> 17 CFR 240.19b-4(f)(6)(iii).

provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR-NASD-2002-26 and should be submitted by May 16, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>16</sup>

**Margaret H. McFarland,**  
Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45789; File No. SR-NYSE-2001-30]

### Self-Regulatory Organizations; The New York Stock Exchange, Inc.; Notice of Filing of Proposed Rule Change To Amend Rule 227 Regarding Depository Eligibility

April 19, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on August 21, 2001, the New York Stock Exchange, Inc. ("NYSE") 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 primarily by NYSE. The Commission is publishing this notice to solicit comments on the proposed rule change from interested parties.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The proposed rule change seeks to amend NYSE Rule 227 by deleting the references to "domestic" and "foreign" issuers in paragraph (a) as well as additional requirements imposed pursuant to paragraph (b) of the rule in order for a security to be depository eligible.

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

In its filing with the Commission, NYSE 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. NYSE has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.

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

The NYSE adopted Rule 227 on June 1, 1995, for the purpose of facilitating implementation of Rule 15c6-1 of the Act that established a three-day settlement period for most securities transactions.<sup>2</sup> Rule 227, which required that domestic issuers' securities be depository eligible before they would be listed, set forth specific requirements for depository eligibility for issuers in order to facilitate the book entry settlement of initial public offerings and to reducing the risks inherent in settling securities transactions.

On May 13, 1996, approximately one year after Rule 227 was approved, the Commission approved a rule change filed by The Depository Trust Company ("DTC")<sup>3</sup> allowing DTC to implement its Initial Public Offering ("IPO") Tracking System.<sup>4</sup> The IPO Tracking System enables lead managers and syndicate members of equity underwritings to monitor repurchases of distributed shares in an automated book-entry environment.

Currently before an issue of securities can be listed, Rule 227(a) requires each domestic issuer to represent to the NYSE that a CUSIP number identifying the security has been included in the file of eligible issuers maintained by a securities depository registered with the Commission as a clearing agency. The proposed amendments would delete the references to "domestic" and "foreign" issuers in paragraph (a). Exclusion of foreign issuers is no longer necessary because they have the capacity to comply with Rule 227 and have been doing so voluntarily for several years.

Rule 227(b) states that a security depository's inclusion of a CUSIP number in its file of eligible issues does not render a security "depository eligible" unless (1) the securities depository has an electronic system for

monitoring repurchases of distributed shares at the time such shares commence trading on the Exchange or (2) when a managing underwriter elects not to deposit the securities on distribution date, it notifies the securities depository no later than three months after the commencement of trading on the NYSE. Rule 227(b) will be deleted as it is no longer relevant since DTC has implemented its IPO Tracking System, which is monitoring repurchases of distributed shares.

In addition, the proposed amendments to Rule 227 should facilitate compliance with the one-day settlement cycle ("T+1") for securities transactions, which is currently scheduled to commence June 2005. The proposed amendments should increase the number of depository-eligible securities which should facilitate the timely settlement of trades and transition to T+1 settlement.

The proposed rule change is consistent with the requirements of sections 6(b)(5) and 17A of the Act and the rules and regulations thereunder requiring the rules of the NYSE be designed to remove impediments to and perfect the mechanism of a free and open market and to perfect a national market system which provides, among other things, for the prompt and accurate clearance and settlement of securities transactions.

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

The NYSE does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

The NYSE has neither solicited nor received written comments on the proposed rule change.

### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within thirty-five days of the date of publication of this notice in the **Federal Register**, or within such longer period (i) as the Commission may designate up to ninety days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the NYSE consents, the Commission will:

(A) by order approve such proposed rule change or

<sup>2</sup> Securities Exchange Act Release No. 35798 (June 1, 1995), 60 FR 30909 (June 12, 1995) [File No. SR-NYSE-95-19] (order approving the adoption of NYSE Rule 227 setting forth requirements on issuers seeking to have their shares listed on the Exchange).

<sup>3</sup> DTC is a securities depository registered with the Commission under sections 17A and 19 of the Act as a clearing agency.

<sup>4</sup> Securities Exchange Act Release No. 37208 (May 13, 1996), 61 FR 25253 (May 20, 1996) [File No. SR-DTC-95-27] (order approving implementation of DTC's IPO Tracking System).

<sup>16</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).