exclude any broker, dealer, person associated with a member, or a member of the immediate family of a person associated with a member. Because the purpose of the system is to provide small retail customers with access to The Nasdaq Stock Market, member firms, with one limited exception, are not permitted to enter proprietary orders. As explained in more detail elow, customers may request that appropriately sized limit and market orders be entered into NAqcess, and if so requested, member firms must honor the customer's request.

Customers may request the entry of limit orders up to 1,000 shares in National Market and SmallCap issues, except for the Nasdaq 100 issues, in which case limit orders up to 3,000 shares may be entered. This represents a difference from the original proposal 10 of 3,000 shares for all National Market issues. 11 The issue of size eligibility for limit orders generated significant comment in response to the two Notices. 12 Many commenters believed that because NAqcess is intended to provide small retail customers with limit order protection, the initial

approach should reflect more closely that the average retail order size is well under 1,000 shares. For example, the Security Traders Association ("STA") noted that the experience of STA members was that the typical retail customer order size averaged well-less than 1,000.13 It was also noted by commenters that it could reduce the potential for investor confusion if NAgcess established a standard for limit orders that was consistent with market order size, 1,000 shares. Commenters also noted that NAqcess could potentially significantly impact market maker participation, particularly in less active securities. As a result, they suggested that the NAqcess order size should be set at lower levels at least until the NASD had thoroughly evaluated the impact of the system on

market liquidity. While the NASD believes that NAgcess will have overall a positive effect on market quality, we believe that it is prudent in this start-up period to commence NAqcess limit order size eligibility at 1,000 shares for most securities. However, limit orders up to 3,000 shares would be eligible for NAgcess for those securities that comprise the Nasdaq 100 Index. The NASD believes that this higher eligibility level is appropriate because the securities comprising the Nasdaq 100 have high levels of volume, greater market maker participation and significant market liquidity and therefore are less likely to be adversely impacted by the proposal. Because of the significant changes that NAqcess may bring to The Nasdaq Stock Market, the NASD believes that it is appropriate to commence the operation of the system with a smaller limit order size than originally proposed to permit market makers and investors to adjust to the new trading environment. The NASD proposes to monitor the limit order size requirement carefully in the initial eighteen months of NAgcess operation and may choose to expand the eligible size of limit orders, if experience demonstrates such expansion to have merit.

Market orders in National Market issues may be 1,000, 500 or 200 shares depending upon tier size determination to be made in the same manner as done in SOES today. 14 Similarly, market

orders in SmallCap issues will be tiered at 500 shares or less as done in SOES today.<sup>15</sup>

Customers may choose to enter "marketable limit orders." A marketable limit order is a limit order that is priced at the time of entry at the current inside market or better on the opposite side of the market, i.e., a marketable limit order to buy is equal to or higher than the current inside offer, while a marketable limit order to sell is equal to or lower than the inside bid. For example, if the current inside market is 20 bid and 201/4 asked, the entry of limit orders to sell priced at 20 or 197/s would be considered marketable limit orders. Marketable limit orders will be treated as market orders. Thus, if a firm enters a customer limit order to sell at 20 at the time the inside bid is 20, the limit order will be passed over the limit order file and if no match occurs, it will be treated as a market order and executed as discussed above in the market order handling section. If such marketable limit order, however, is greater than 1,000 shares in a Nasdaq 100 security, the marketable limit order will be returned to the order entry firm for handling outside of NAqcess, without matching against the inside market whether the inside consists of a dealer quote, limit order(s), or an aggregation thereof.

Neither a limit order nor a market order may be split up to meet the size parameters of NAqcess. The NASD will examine order handling practices of

<sup>&</sup>lt;sup>7</sup>The only exception to the proprietary order prohibition is an order designated by a market maker as a "marker order." A marker order is a principal order entered by a market maker in a transaction that is functionally the equivalent of a riskless principal transaction. The firm may place a principal account limit order in the NAqcess file, and if an execution is obtained, immediately pass along the benefit of such execution to a retail customer order it holds in its own file. Because the order is part of a principal transaction for the benefit of the retail customer, the NASD believes that it is appropriate to permit this limited exception to the prohibition of proprietary orders in NAgcess. The NASD will require member firms entering such orders to mark their order tickets accordingly, and will examine a firm's trading activities carefully to determine that such proprietary orders are being effected for the purposes of engaging in a riskless principal-like transaction, Marker orders, however, may not be placed with respect to customer limit orders held by the firm that exceed the permitted maximum limit order size.

<sup>&</sup>lt;sup>8</sup>Member firms will be permitted, however, to enter so-called "takeout" orders for their own account or on behalf of a customer. A takeout order is an order that results in an immediate automatic execution of a limit order or orders in the NAqcess limit order file at the limit order price(s). There is no size limitation on the takeout order. Thus, if the NAqcess file displays limit orders at a price with an aggregate size of 15,000 shares, a single takeout order of 15,000 shares may be entered and executed. Similarly, a firm may enter a takeout order to immediately execute multiple limit orders at multiple prices in the NAqcess file. When there are multiple limit orders being taken out, each limit order will execute at each limit order's price.

 <sup>&</sup>lt;sup>9</sup> See infra Section II(A)3.A of this proposal.
<sup>10</sup> NASD Special Notice to Members 95–20 (Mar. 21, 1995).

 $<sup>^{11}</sup>$  All SmallCap issues have a limit order size of 1,000 shares.

 $<sup>^{12}\,</sup>NASD$  Special Notice to Members 95–20 (Mar. 21, 1995) and 95–60 (July 27, 1995).

<sup>&</sup>lt;sup>13</sup> See letter from John Giesea, Chairman, and John Watson, President, STA (Apr. 28, 1995).

<sup>&</sup>lt;sup>14</sup>Under SOES Rules, the tier sizes of 1,000, 500 and 200 shares were determined by reference to the average daily non-block volume of a security, among other things. Thus, for example, if an issue had an average daily non-block volume of 3,000 or more shares, it could qualify for a tier size of 1,000 shares

The same concept will apply with respect to NAqcess maximum market order sizes, except that the NASD has determined to use a slightly higher average daily non-block volume of 6,000 shares. The NASD has chosen this higher level because it better reflects trading patterns consistent with the increased overall volume in Nasdaq securities.

<sup>15</sup> The NASD will permit market makers to establish minimum exposure limits that are equal to the maximum market order size. In addition, NAgcess will contain an automated update feature that will automatically change the market maker's quotation by a minimum increment set by the market maker after the market maker has executed a trade at a price level and has exhausted its minimum exposure limit through system executions. The NASD believes that these aspects of NAqcess are critical to an effective operation that permits a market maker to manage its risk capital, and is consistent with the SEC firm quote rule as applied to all other registered markets. The minimum exposure limit is set at the same size as the minimum quote size in Nasdaq. Under the SEC Firm Quote Rule (Rule 11Ac1-1(c)), a broker-dealer is entitled to change its quotation within a reasonable period of time after it has completed a trade at its published price. Accordingly, the NASD believes that these aspects of NAqcess are consistent with SEC and NASD rules and provide retail investors with the same access to dealer quotations as are available in any other registered marketplace.