order entry firms to determine compliance with this requirement. 16

C. Display of Limit Orders. To enhance the transparency of The Nasdaq Stock Market and to assist in the price discovery process, the NASD will provide for the display of limit orders entered into NAqcess. There will be two separate approaches to the display: a consolidated inside market display and the Full File Display.

1. Inside Market Display. In a significant revision to Nasdaq's methodology for calculating the inside market for Nasdaq securities, The Nasdaq Stock Market will include in the Nasdaq inside market NAqcess limit orders, and their aggregate sizes, that are priced the same as or better than the best dealer bid and offer.17 Thus, in Nasdaq the inside market will consist of a single display of the best priced quotes or limit orders, as the case may be. The inside market will be calculated in the following manner. If the best limit order(s) to buy (sell) in NAqcess is (are) better than the best Nasdaq market maker bid (offer) displayed in Nasdag and such limit order(s) is (are) 100 shares or more, it (they) will be included in the Nasdaq inside market and disseminated as the inside bid (offer), together with the aggregate size of such order(s) and a unique indicator to denote that the inside market is represented by a NAgcess limit order or orders, rather than a quotation of a Nasdaq market maker or UTP exchange quotation. If there are multiple limit orders at the best price, aggregate size will be displayed and execution of such

orders will occur on a time priority basis as explained below.

If the best-priced NAqcess limit order(s) is (are) equal to the inside dealer quotation, the limit order size will be reflected in the aggregate size of the quotation. That is, if there is a limit order to buy 500 shares at the same price as a 1,000 share dealer bid quotation, and both are the best bids reflected in Nasdaq, the aggregated size displayed as the best Nasdaq bid will reflect a size of 1,500 shares with a special indicator to denote that such size is an aggregation of a dealer quote and any limit order(s) at that price. Priority for execution will depend upon the general limit order priority rules, i.e., if the limit order is received prior to the market maker quotation, it will be entitled to priority for execution purposes.¹⁸

The inclusion of NAqcess limit orders in the Nasdaq inside market represents a significant enhancement to The Nasdag Stock Market. Consolidation of NAgcess orders into the Nasdaq inside quotation is the best means to communicate clearly to all investors in Nasdag the true market for such securities at any particular point in time. The consolidation of best-priced limit orders with the best dealer bid and offer in Nasdaq provides the best level of transparency and aids in the price

discovery process.

Although this represents a change from the original NAgcess proposal, 19 the NASD believes that the display of this consolidated information maintains the advantages of a competing dealer market while permitting an expansion in information available to investors.20 The new inside quotation display will clearly identify when aggregated customer limit orders are represented in the inside market display. Accordingly, market participants will be able to ascertain when the inside quotation represents a customer limit order and when it represents a market maker whose quotation may signify that it is

available to effect a significantly larger sized transaction. In this way, the NASD believes that transparency of customer orders may be enhanced while the integrity of the dealer quotation is preserved.

2. Full File Display. The full file display for a particular security will be made available on a query basis over Nasdaq Workstations only to Nasdaq market makers in that security. The NASD believes that, as with other U.S. market centers, display of the entire limit order file should be reserved to market makers in a particular security to assist in price discovery and to provide the market maker with an incentive to provide liquidity by risking its capital. In fact, no U.S. exchange registered with the SEC publicly disseminates any display (full or partial) of a limit order book maintained by an exchange specialist. Because of the accompanying rules described below that the NASD has proposed, customer limit orders in the file will be protected to a large extent, from inferior executions.

D. Order Processing. The NAqcess system will provide significant improvements over the current SOES system in the way that customer limit orders and market orders will be handled. NAqcess will attempt to match all incoming orders, limit or market, directed or non-directed, against limit orders already resident in NAqcess on a price and time priority basis.21 If a match is found, the orders will be automatically executed against each other without the participation of a market maker. For example, assume the current inside market for a security is 20-201/2 and customers enter into NAqcess a 1,000 share limit order to buy at 201/8 and a 1,000 share limit order to sell at 203/8. The new inside market will become 20½-20¾. If a customer thereafter enters a 1,000 share limit order to sell at 201/8, the incoming limit order to sell will match against the 1,000 share limit order to buy on the NAqcess file at 201/8 and will be executed against that order. If a

¹⁶ In this regard, the NASD notes that order entry firms may enter agency orders only. The rules continue in effect the definition of agency orders as found in the current SOES Rules and the new rules carry forward the existing principles regarding the aggregation of orders based on a single investment decision entered by an order entry firm. Orders entered by an order entry firm within any five minute period in accounts controlled by associated person or public customers, acting alone or in concert with other associated persons or public customers are presumed to be based on a single investment decision. In connection with this rule, the NASD notes that it will examine carefully the entry of computer-generated orders to determine whether such orders are based upon a single investment decision.

 $^{^{\}rm 17}\!$ This is a change from the approach originally proposed in Special Notice To Members 95-20 and 95-60. In the original NAqcess approach to the display of NAqcess limit orders, the NASD proposed to provide two separate displays of prices: the inside dealer quotation (i.e., the best-priced bids and offers of Nasdaq market makers and UTP exchanges displayed in the Nasdaq market) and the top of the NAqcess limit order file (i.e., the best priced limit orders to buy and sell and their aggregate sizes). Such displays would have been separate and side-by-side. Under this new proposal, the NASD will maintain a Top of the File display on its Nasdaq Workstations, as well as include the best priced limit orders to buy and sell in the Nasdaq inside market display.

¹⁸ Rules regarding calculation of the excess spread will not include NAqcess limit orders for purposes of determining compliance with those Rules. See NASD Manual, Schedules to the By-Laws, Schedule D, Part V, Sec. 2(d), CCH ¶ 1819.

¹⁹ NASD Special Notice to Members 95-60 (July 27, 1995).

 $^{^{\}rm 20}\, \rm One$ commenter specifically noted that a consolidated display of the best priced limit orders in the Nasdaq inside market was a better approach than maintaining separate displays, especially since member best execution obligations would be determined by reference to the best prices displayed by Nasdaq, whether such prices were dealer quotes or limit orders in NAqcess. See Lehman Bros. (Sept. 12, 1995). In addition, several vendors expressed technological concerns regarding separate displays. See letters from ADP (Aug. 16, 1995) and Telekurs (Aug. 14, 1995).

²¹ NAqcess will match only round lots and round lot portions of mixed lot orders. Odd lot limit orders will not be matched. Odd lots are orders less than 100 shares. Odd lot limit orders will not be displayed in the inside quotation; however, odd lot limit orders will be displayed in the full file display. If an odd-lot order is executable i.e., if it is a market order or an executable limit order, it will be automatically executed at the applicable inside dealer quotation. If it is a directed order, it is executed against the directed market maker. If it is a non-directed order, it will be executed automatically without any decline capability against the next available market maker at the inside dealer quotation. If the odd-lot order is a limit order that is not executable at time of entry, it will remain in the file until the inside dealer quotation moves to match the odd-lot price.