customer next sends in a market order to buy in NAqcess, the market order will match against the limit order to sell at 203/8, rather than the dealer offer of 201/2, and thus, the market order will be automatically executed immediately at 203/8. In both cases, the orders received price improvement over the dealer quotation and immediate execution without the participation of a market maker.

If, in the scenario set forth above, the second limit order to sell is priced at 20 instead of $20\frac{1}{8}$, the execution price would be $20\frac{1}{8}$, the price of the limit order to buy because such order was entered into the system earlier than the second limit order to sell.

The system will only execute such matches when the execution prices would be equal to or better than the inside market. Nevertheless, limit orders priced away from the inside market, i.e., limit orders to sell priced higher than the inside offer and limit orders to buy priced lower than the inside bid, will be stored in the NAgcess file. When the inside market moves to a price so that the limit order is equal to or better than the inside dealer quotation, such limit orders will be consolidated into the Nasdag inside market and the limit order will become eligible for matching as described in this section.

When a limit order in the NAqcess file is priced the same as the inside market, the time priority of the limit order compared with the best dealer quotation will govern which price interacts first with incoming orders in NAqcess. The NASD believes that this approach is a well-understood and reasonable means for determining the interaction of such orders and provides a further incentive to market makers to provide liquidity and narrow spreads.

If no limit orders reside in the NAqcess file, market orders will be immediately assigned and distributed to market makers at the inside market. This rapid distribution should minimize the potential for queues that the original proposal found in Notice To Members 95–20 could have caused. After an order is distributed to a market maker, the market maker will be permitted a 20-second period within which it may decline a non-directed order if such action is consistent with the exceptions to the SEC's firm quote rule, Rule 11Ac1–1.²² In other words, the market

maker is permitted to decline the NAgcess order if the market maker, immediately before the presentation of the NAqcess order: (a) effected or was in the process of effecting a trade, and (b) was in the process of updating its quotation to reflect that previous transaction. When a NAgcess order is declined by a market maker, the declined order is presented to the next available market maker. If that market maker is at the same price as the market maker that originally declined the order, the second market maker also has a 20second period to react to the order. If the second time the order would be presented, the inside market has moved to a different price level, it is automatically executed without any decline capability. For example, four market makers are at the inside bid of 20. Three market orders to sell are entered into NAqcess when there are no limit orders to buy at 20 or better. Each market order is immediately distributed to one of the three market makers. Because the first market maker had completed a trade by telephone and was about to change its quotation, the first market order is declined by the first market maker. That order is redistributed to the fourth market maker still quoting a price of 20. The fourth market maker has 20 seconds to interact with the order. If, however, there were only three market makers at 20, and all market makers had updated their quotations to reflect a price of 197/8, the declined order would be immediately executed at 197/8 against the first available market maker without any decline capability.

The NASD is developing an automated surveillance capability to monitor on a real-time basis whether an order was properly declined. The NASD believes that this capability is crucial to engendering investor confidence in the

systems and the market maker. Thus, the NASD has purposefully designed a 5-second period to accommodate the transmission of messages between the NASD host computer and member firm presentation devices. This five-second period addresses the potential delays of 3.75 seconds that may occur in broadcasting a message from the host to a workstation, and the .775 seconds that could occur in transmitting a decline message from the presentation device to the host. (It should be noted that such time periods arise in the context of the current configuration of the proposed system. Development of alternative methods of processing could increase the total time delays.) In examining the potential length of time that a message could consume in transmission from the host to the presentation device and back again, the NASD determined that market makers would be at a significant time disadvantage in that a market maker could lose up to 33% of its already limited reaction period. In this context, then, the NASD believes that it is appropriate to recognize the inherent delays of computer-to-computer data exchange, and provide additional time to account for such delays.

firmness of Nasdaq market maker quotations and should alleviate any concerns regarding "backing away" questions. The NASD notes that the 15-second decline feature was criticized in the context of the N•Prove proposal.²³ The NASD believes that this proposal to develop a real-time automated surveillance capability should alleviate any concerns about the "decline" capability. The NASD will undertake strong disciplinary measures against any firm that displays a pattern and practice of improper order declines.

Order entry firms have two alternatives in entering NAqcess orders—they may direct the order to a particular market maker with whom they have established a direct order arrangement, or they may enter a non-directed order. In either circumstance, market orders and marketable limit orders will first pass over the limit order file to obtain a match before execution against a market maker. If an order is directed pursuant to a valid agreement between the order entry firm and the market maker, the market maker may not decline the order.

E. Opening Procedures. NAqcess will have special opening procedures that are consistent with the opportunities for order matching and price improvement over the dealer quotation provided intra-day by NAqcess.

NAgcess's operating hours are from 9:30 a.m. to 4:00 p.m. (EST). However, limit orders may be entered and stored in NAgcess from 4:00 p.m. to 6:00 p.m. and limit and market orders may be entered from 8:30 a.m. to 9:28 a.m. At 9:28 a.m., no further orders for opening purposes will be accepted.²⁴ At 9:30 a.m., Nasdaq will rank all limit orders stored as of 9:28 a.m. according to price and time of entry. To the extent orders are available, the system will then match the best-priced sell limit orders against the best-priced buy limit orders in the file that are within the best dealer bid and offer as determined at 9:30 a.m. When all available limit order matches are effected, any remaining limit orders within the inside dealer quote at 9:30 a.m. will be matched against market orders stored as of 9:28 a.m. and will be executed at such limit order prices. Any remaining orders will be subject to the normal intra-day, order distribution and execution procedures. It should be noted that this opening procedure will not create a single, unitary price for all orders in NAqcess. The individual

²² While the total time period between order entry and Nasdaq receipt of the decline is 20 seconds, the system has been designed to provide market makers with a full 15-second period in which to react to an order. The rule itself references a 15-second period in which the market maker must react. Five seconds of the 20-second period is designed to accommodate communications between Nasdaq

 $^{^{23}\,}See$ Securities Exchange Act Release No. 35275 (Jan. 25, 1995), 60 FR 6327 (Feb. 1, 1995).

²⁴ Orders entered from 9:28 a.m. to 9:30 a.m. will be stored and handled after the opening in line with ordinary matching and handling procedures described above.