until May 1, 1995.[6] For the reasons discussed below, this order approves the proposed rule change until March 27, 1995.

II. Description of the Proposed Rule Change

As noted above, the NASD has proposed to extend three of the four Interim SOES Rules that became effective January 25, 1994. The proposal does not include extending the short sale prohibition beyond January 25, 1995; thus, effective January 26, 1995, short sales in compliance with the NASD's short sale rule applicable to the Nasdaq market as a whole will be permitted in SOES.[7] The following restrictions will be effective until March 27, 1995:

(1) *SOES Maximum Order Size:* The maximum size order eligible for SOES execution will be 500 shares for the highest tier of Nasdaq National Market securities.[8]

(2) *SOES Minimum Exposure Limit:* The market maker's SOES minimum exposure limit will be two times the maximum order size. The rule change continues the application of the minimum exposure limit to unpreferenced orders only, so that preferenced orders will not count toward depletion of the minimum exposure limit.

(3) *Automated Quotation Updates:* The NASD proposes to continue providing an automated quotation update function for marker makers using SOES, at their election, on an issue-by-issue basis. If the automated update function is not used, when a market maker depletes its exposure limit in SOES, the market maker's quotation is closed to SOES executions until the market maker updates its quote and reestablishes its exposure limit. If used, the function updates a market maker's quotation in any Nasdaq security when its exposure limit has been exhausted, and reestablishes the original quotation size and exposure limit, thereby preventing closed quotations. Market makers electing to use the feature can set the fractional interval of the quotation update for each security and set their exposure limit at the maximum order size for that security that is, 500 shares for the highest tier of Nasdaq National Market securities.

In light of the NASD's implementation of short sale prohibitions on September 6, 1994,[9] the NASD will terminate the prohibition against short selling through SOES. Thus, beginning January 26, 1995, short sales in compliance with the NASD's short sale rule will be permitted through SOES.

III. Comments

Commenters supporting and opposing the proposal stated reasons similar to those put forth in response to the NASD's original proposal to adopt the Interim SOES Rules.[10] Commenters supporting the proposal argue that the Amended Interim SOES Rules will limit the exposure of market makers to multiple executions, which should produce narrower spreads and more liquid markets. Those opposing extension of the rules argue that market makers have ample opportunity to update their quotes in order to avoid multiple SOES executions. They contend that two studies submitted by proponents of the rules fail to show any increase in market quality as a result of the rules. They also argue that the SOES immediate automatic execution feature provides them the only meaningful access to the Nasdaq market because, they allege, market makers do not honor their quoted prices on the telephone or through SelectNet. These commenters assert that they cannot obtain quote-based trade executions except through SOES and that the Interim SOES Rules have thereby restricted their access to Nasdaq and the ability of certain customers to receive executions at quoted prices. These commenters argue that the Interim SOES Rules thus produce unfair discrimination and an inappropriate burden on competition.

IV. Discussion

The Commission must approve a proposed NASD rule change if it finds that the proposal is consistent with the requirements of the Act and the rules and regulations thereunder that govern the NASD.[11] In evaluating a given proposal, the Commission examines the record before it and relevant factors and information.[12] After balancing the advantages and disadvantages of extension, the Commission believes that limited extension of the Amended Interim SOES Rules through March 27, 1995 meets the above standards and is necessary and appropriate in the public interest and for the protection of investors. As discussed in more detail below, the Commission does not believe that, on the basis of the information before it, an extension of the Amended Interim SOES Rules beyond 60 days is justified under the applicable statutory standard. Nevertheless, because much information has been made available only recently, the Commission has determined that it is appropriate to provide this brief phase-out period (until March 27, 1995), which will enable the market to make an orderly transition.[13]

Because the Interim SOES Rules were approved only for a pilot period, the Commission noted in its approval order that it expected to revisit the issues presented by the NASD's proposal.[14] In

[6] Letter from T. Grant Callery, Vice President & General Counsel, NASD, to Mark Barracca, Branch Chief, SEC (Jan. 23, 1995).

[7] NASD Manual, Rules of Fair Practice, Sec. 48, CCH ¶ 2200H.

[8] Market makers must continue to display a size of 1,000 shares in their quotations for these securities, and to be firm for a minimum of 1,000 shares at their published quotation, for any negotiated transaction through SelectNet or over the telephone. See NASD Manual, Schedules to the By-Laws, Schedule D, Part VI, Sec. 2(a)—(b), CCh ¶ 1819.

[9] Securities Exchange Act Release No. 34277 (June 29, 1994), 59 FR 34885 (July 7, 1994) (approval of the NASD's short sale rule, effective September 6, 1994).

[10] These comments addressed the proposal to extend the Interim SOES Rules through May 1, 1995, as originally filed. As amended, those rules would now expire March 27, 1995. See *supra* note 5.

[11] 15 U.S.C. § 78s(b). The Commission's statutory role is limited to evaluating the rules as proposed against the statutory standards. See S.Rep. No. 75, 94th Cong., 1st. Sess., at 13 (1975).

[12] In the 1975 Amendments, Congress directed the Commission to use its authority under the Act, including its authority to approve SRO rule changes, to foster the establishment of a national market system and promote the goals of economically efficient securities transactions, fair competition, and best execution. Congress granted the Commission "broad, discretionary powers" and "maximum flexibility" to develop a national market system and to carry out these objectives. Furthermore, Congress gave the Commission "the power to classify markets, firms, and securities in any manner it deems necessary or appropriate in the public interest or for the protection of investors and to facilitate the development of subsystems within the national market system." S. Rep. No. 75, 94th Cong., 1st Sess., at 7 (1975).

[13] The Commission does not believe that further extension of these restrictions without changes to benefit public investors would be appropriate.

[14] Both proponents of and opponents to the 1994 Interim SOES Rules argued that imposing the rules would affect the Nasdaq market. Opponents argued that the rules would heighten volatility and widen spreads. *E.g.*, Letters to Jonathan G. Katz, Secretary, SEC, from Michael Frey, President, A.J. Michaels & Co., at 7 (May 11, 1993); Douglas P. Ralston, President, Shearman, Ralston Inc., at 1 and 6 (May 10, 1993); and Harvey L. Pitt, counsel for Dina Securities, Inc., at 15 (June 11, 1993). The NASD and its supporters, on the other hand, argued that placing certain restrictions on the use of SOES, for example, lowering the maximum order size, would act to decrease volatility and narrow spreads. Securities Exchange Act Release No. 32143 (Apr. 14, 1993), 58 FR 21484 (Apr. 21, 1993) (notice of the NASD's proposed Interim SOES Rules, File No. SR–NASD–93–16). The Commission's December 1993 SOES order describes in some detail the order size reduction, the minimum order exposure limit reductions, and the automated quotation update feature that the NASD proposes to extend. See Securities Exchange Act Release No. 33377 (Dec. 23, 1993), 58 FR 69419 (Dec. 30, 1993). That order also discusses the NASD's rationale for these