approving the Interim SOES Rules, the Commission noted its concern over the lack of reliable statistical analysis. The Commission approved the rules, however, among other reasons, because of the rules' limited duration and because of the agency's commitment to monitor the rules' effects.[15] The Commission stated that extension of the Interim SOES Rules or other similar modifications upon expiration of the Interim SOES Rules would ''require an independent consideration under Section 19 of the Act.''[16]

In connection with its extension request, the NASD submitted an econometric study conducted by the NASD's Economic Research Department[17] and commissioned a consulting economist to provide an assessment of the effect of the Interim SOES Rules.[18] In summary, the NASD's Economic Research Department found that since implementation of the Interim SOES Rules: (a) Spreads in Nasdaq securities have declined; and (b) volatility of Nasdaq securities appears to be unchanged, except for brief, market-wide period of volatility in March and April 1994. The commissioned study reported that while percentage quoted spreads increased a statistically insignificant amount, percentage quoted spreads, adjusted for other determining factors, declined by a statistically significant, but economically insignificant, amount. From this data, the author concluded that the Interim SOES Rules did not harm market quality.

An evaluation of the empirical data submitted by the NASD does not persuasively demonstrate that the quality of the market improved subsequent to the adoption of the Interim Rules. The evidence in both studies shows that spreads declined, but the results were only marginally significant, and the size of the reduction is too small to be important. Nevertheless, the Commission believes that these studies demonstrate that the Interim Rules have operated for one year with no apparent significant negative implications for overall market quality.

The absence of negative implications for market quality must be considered in conjunction with other effects of the Interim SOES Rules on the investing public. Commenters opposed to the Interim SOES Rules argue that the restrictions impose a burden on the ability of some customers to obtain execution of transactions in size in the Nasdaq market. They contend that, to the extent that the Interim Rules restrict their access to SOES, their ability to obtain executions is limited because they cannot effectively trade over the telephone and through SelectNet. In support of these arguments, they refer to a large number of complaints alleging that market makers have refused to fill trades now ineligible for SOES execution at their quoted prices. In addition, they have provided anecdotal information that certain SOES order entry firms have suffered serious drops in daily trading volume since approval of the Interim Rules. The Commission takes such allegations seriously, and is reviewing them as part of its obligation to oversee the securities markets.

As indicated above, the Commission has determined to approve the Amended Interim Rules through March 27, 1995. In light of the balance of factors described above, the Commission does not believe that further extension of this proposal would be appropriate.[19] The short extension the Commission has determined to approve will permit the market to make an orderly transition to operation in a changed environment. The Commission believes that such a measure is appropriate in the public interest. Moreover, the Commission notes that the Amended Interim Rules, unlike the rules currently in effect, will permit the entry of short sale orders. The Commission believes this will ameliorate during the phase-out period the burdens associated with the Interim SOES Rules by expanding the types of orders that are eligible for automatic execution.

The Commission notes that subsequent to approval of the Interim SOES Rules in December 1993, the NASD submitted a proposal to replace SOES with the Nasdaq Primary Retail Order View and Execution System (''N•PROVE''). As currently proposed, N•PROVE would differ from SOES in two general ways:

- N•PROVE would provide a facility for automated routing and execution of small orders, allowing market makers a 15 second opportunity to decline an order (if consistent with the Firm Quote Rule, permitting a brief period for quote updates). SOES generally provides immediate execution of orders against an assigned market maker at the best bid or offer and thereafter notifies the affected market maker; and
- N•PROVE would provide an opportunity for public limit orders to interact with other limit orders and incoming market orders, and for execution of market orders at prices superior to the best market maker quotes. SOES provides limited opportunity for such interaction.

In light of comments received as recently as January 9, 1995 concerning N•PROVE, as well as other developments in the Nasdaq market,[20] the Commission believes that the NASD's N•PROVE proposal warrants further assessment. Among other matters, commenters have raised concerns about the NASD's ability to monitor sufficiently market maker compliance with the Firm Quote Rule and the potential for significant order queues to develop. Before further Commission action on N•PROVE, the Commission believes that the NASD should address such issues, including the potential for queuing during periods of market stress, whether there are restrictions on access to the system inconsistent with the purposes of the Act, and whether there are adequate mechanisms to ensure effective oversight of market makers' compliance with the Firm Quote Rule.

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changes to the SOES rules and the Commission's rationale for approving them for a one-year period.

[15] Securities Exchange Act Release No. 33377 (Dec. 23, 1993), 58 FR 69419 (Dec. 30, 1993).

[16] Securities Exchange Act Release No. 33377 (Dec. 23, 1993), 58 FR 69419 (Dec. 30, 1993) (footnote omitted). The Commission's order further stated that ''[t]he NASD should consider whether additional criteria for evaluating the effectiveness of the modifications are appropriate, and should include in its assessment of the modifications all factors that it deems relevant in evaluating the effects of the modifications [and] . . . [i]f an assessment is not feasible, the NASD should provide a reasoned explanation supporting that determination.'' *Id.*

[17] Securities Exchange Act Release No. 35080 (Dec. 9, 1994), 59 FR 65109 (Dec. 16, 1994). The NASD's Economic Research Department examined Nasdaq bid-ask spreads in specific stocks and price volatility on two sample days each month from November 1993 (three months prior to the effective date of the rules) through August 1994.

[18] Letter from John F. Olson, Counsel for the NASD, Gibson, Dunn & Crutcher, to Jonathan Katz, Secretary, SEC (Dec. 30, 1994) (submitting in connection with File No. SR–NASD–94–68 analysis entitled the Association Between the Interim SOES Rules and Nasdaq Market Quality prepared by Dean Furbush, Ph.D., Economists Incorporated (Dec. 30, 1994)). This analysis compared sample days in the three months prior to and three months after the effective date of the Interim SOES Rules.

[19] Of course, a different proposal that modified the Amended Interim Rules to provide additional public benefits would require an independent Commission determination.

[20] As has been widely disclosed, the Commission is conducting an inquiry into certain practices in the Nasdaq market and the Antitrust Division of the Department of Justice recently has made public an inquiry into whether Nasdaq market makers are violating federal antitrust laws. Although not tied directly to the Commission's consideration of the instant proposal, the Commission expects that these inquiries may provide valuable information that will affect future reform efforts and ultimately improve the quality of the Nasdaq market. In addition, the NASD has formed a committee headed by former U.S. Senator Warren Rudman to review the effectiveness of the operation and surveillance of Nasdaq and the governance of the NASD and Nasdaq.