

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

SECURITIES EXCHANGE ACT OF 1934
Release No. 34-18689/April 28, 1982

NATIONAL ASSOCIATION OF SECURITIES DEALERS (“NASD”)
(SR-NASD-79-1)

ORDER APPROVING PROPOSED RULE CHANGE

On March 8, 1982, the NASD filed with the Commission, pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934, 15 U.S.C. 78s(b)(1), (the “Act”) and Rule 19b-4 thereunder, Amendment No. 1 to a proposed rule change originally filed on January 22, 1979 (SR-NASD-79-1). The proposed rule change, as amended (“amended proposal”), would amend Schedule D, Part I, §C.3(e) of the NASD’s By-Laws to require a registered market maker to clear and settle through the facilities of a registered clearing agency transactions in all securities in which that market maker makes quotes available through the National Association of Securities Dealers Automatic Quotation System (“NASDAQ securities transactions”) when such facilities are located within 25 miles of the market maker. The amended proposal, however, would permit a market maker to clear and settle such transactions through any registered clearing agency using a continuous net settlement system; to enter into a correspondent clearing arrangement with an NASD member that clears through a continuous net settlement clearing facility; to settle such transactions “ex-clearing” provided both parties to the transaction agree; or to use direct mail settlement.

Notice of the amended proposal, together with the terms of substance of the amended proposal was given by publication of a Commission Release (Securities Exchange Act Release No. 18575, March 19, 1982) and by publication in the Federal Register (47 FR 12896, March 25, 1982). No comments on the amended proposal were received by the Commission.

The NASD’s original proposed rule change (Securities Exchange Act Release No. 15559, February 9, 1979; 44 FR 10163, February 16, 1979) (“original proposal”) provided without exception that a registered market maker would have to clear and settle NASDAQ securities transactions through the facilities of a registered clearing agency if such facilities were located within 25 miles of a market maker. Unlike the amended proposal, however, the original proposal did not provide for alternative ways to satisfy the requirement.

The Commission received public comments concerning the original proposal and the NASD forwarded to the Commission comments that it received, including comments received in response to a survey conducted by the NASD to assess the likely impact of the original proposal on market makers. Comments on the original proposal generally were favorable. Commenters noted, for example, that the original proposal would reduce the delays and costs involved in resolving uncompleted trades involving market makers that did not participate in the national clearance and settlement system, would reduce the number of fails in the over-the-counter market during higher volume periods, would facilitate the development of a more efficient national clearance and settlement system, and would strengthen the role of the over-the-counter market in the national market system.¹ A few commenters asserted, however, that the proposed rule change as originally filed (i) would require market makers within the 25-mile radii to use the particular clearing facilities close to them, rather than the facilities of their choice; and (ii) would require market makers that currently do not use any clearing agency to change their clearing arrangements, which they argued would increase their costs of doing business and thereby reduce their ability to compete effectively as market makers.²

As a general matter, the Commission believes that the amended proposal either eliminates or substantially reduces any potentially adverse effects of the original proposal. As the NASD's survey results suggests, only a small percentage of NASDAQ market makers are likely to be affected by the amended proposal,³ and those market makers will be able to satisfy the requirements of the rule in a number of alternative ways. For example, the amended proposal would permit market makers to participate in any registered clearing agency, to establish

¹ Letters from Jerry Williams, Jerry Williams, Inc. to NASD (June 6, 1978); Edward W. Wedbush, Wedbush, Noble, Cooke, Inc. to NASD (June 5, 1978); Jack Rubens, Monroe Securities, Inc. to NASD (May 31, 1978); Herbert I. Levitt, Spear, Leeds & Kellogg to NASD (December 5, 1980); Herbert I. Levitt, Spear, Leeds & Kellogg to the Commission (May 11, 1981); Herbert I. Levitt, Spear, Leeds & Kellogg to the Commission (October 9, 1981); S. Muir Atherton, Pacific Clearing Corporation and Pacific Securities Depository Trust Company to the Commission (May 15, 1980); and Edward I. O'Brien, Securities Industry Association to the Commission (September 30, 1981).

² Letters from Gene S. Olson, Securities Clearing of Colorado, Inc. to NASD (June 19, 1978); Joseph F. Dugos, Omega Securities, Inc. to NASD (June 14, 1978); Kenneth W. Cole, First Colorado Investments & Securities, Inc. to NASD (June 16, 1978); Randall Vanek, Harper, McLean & Co. to NASD (June 7, 1978); and John J. Carroll, John J. Carroll & Co. to NASD (May 30, 1978). The NASD also received some unfavorable comments on the original proposal in response to its survey of NASDAQ market makers.

³ NASD, [Results of] Questionnaire on Market Makers' Use of Clearing Facilities, attached to letter from Frank J. Formica of the NASD to the Commission (October 7, 1980) (File No. SR-NASD-79-1). The survey indicated that 12 of the 225 firms responding to the NASD survey would have to establish new clearing arrangements to comply with the terms of the original proposal.

correspondent clearing arrangements with an NASD member that clears trades through a continuous net settlement clearing facility, to clear and settle transactions “ex-clearing” whenever both sides to the trades agree, or to use direct clearing services.

The Commission does recognize that the amended proposal will require some market makers to enter into new arrangements for clearing and settling NASDAQ securities transactions and that such a requirement arguably may increase those market makers’ costs for clearing and setting transactions.⁴ If so, the Commission appreciates that the amended proposal may provide a disincentive to NASDAQ market making by those firms. Nonetheless, the Commission believes that any theoretical burden that may be imposed on competition by the amended proposal is necessary and appropriate to further other purposes of the Act, including purposes articulated in Sections 15A and 17A of the Act.⁵ Currently, absent the proposed rule change, market makers that are not members of clearing agencies force contra parties that trade with them to process trades “ex-clearing”, even if the contra parties participate in the national clearance and settlement system through a registered clearing agency. That result, in effect, means that contra parties must use inconvenient, time-consuming and often costly manual processing methods for some over-the-counter trades, notwithstanding their preference to process such trades through registered clearing facilities. Moreover, as a general matter, that forced reliance on antiquated clearance and settlement mechanisms during high volume periods delays trade completion, increases the industry’s cost of executing and processing trades, and reduces the percentage of trades that are settled on time.⁶ Such results frustrate development of the prompt, accurate, and efficient national system for the clearance and settlement of securities transactions called for by Congress in Sections 17A and 15A of the Act.⁷

⁴ As a factual matter, however, the Commission questions whether use of clearing agencies would increase the aggregate clearing costs for any particular NASDAQ market maker. The Commission believes that, in general, the efficiencies inherent in clearing agency usage provide significant clearing economies to broker-dealers. Indeed, the Commission expects that market makers affected by the amended proposal may well find their aggregate clearance and settlement costs reduced through direct or indirect participation in the national clearance and settlement system.

⁵ When enacting the Securities Acts Amendments of 1975, Congress intended the Commission to evaluate proposed rules by balancing any perceived anticompetitive effects of the rule against other regulatory objectives of the Act that the rule would further. H.R. Rep. No. 94-229, 94th Cong., 1st Sess. 100 (1975).

⁶ See e.g., letters from Herbert J. Levitt, Spear, Leeds & Kellogg to NASD (December 5, 1980) and Edward W. Wedbush, Wedbush, Noble, Cooke, Inc. to NASD (June 5, 1978).

⁷ Section 17A of the Act recognizes the need to extend the use of automation and reduce inefficient procedures in securities processing. Section 15A of the Act provides that the rules of a registered securities association must be designed to foster cooperation and coordination with persons engaged in regulating, clearing, settling, and facilitating securities transactions.

Finally, the Commission notes that the requirements of the amended proposal would not apply to all NASD members, but only to market makers in NASDAQ securities. Because NASDAQ market makers play a central role in defining the relative efficiency of the nation's over-the-counter securities markets, the Commission believes the focus of the amended proposal is particularly appropriate. In our view, market makers should not be able to compel parties that deal with them to clear and settle trades inefficiently. Indeed, absent the proposed rule change, market participants may decline to trade with an "ex-clearing" market maker that displays the best bid or offer in a NASDAQ security, simply because those participants do not wish to incur the added incremental costs of processing such trades "inefficiently." Such a result, of course, frustrates the statutory goals of ensuring best execution of public orders and enhancing competition among brokers and dealers.⁸

Accordingly, the Commission believes that the proposed rule change would foster the use of efficient clearing arrangements and thereby facilitate the establishment of a prompt, accurate and efficient national system for the clearance and settlement of securities transactions. The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to registered securities associations, and in particular, the requirements of Sections 11A, 15A, and 17A of the Act.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change be, and it hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.

George A. Fitzsimmons
Secretary

⁸ See Sections 11A(a)(1)(C) and 15A(b)(6) of the Act.

SEC NEWS DIGEST
SELF-REGULATORY ORGANIZATIONS

APPROVAL OF PROPOSED RULE CHANGE

The Commission has approved a proposed rule change (SR-NASD-79-1) filed by the National Association of Securities Dealers (“NASD”). The proposed rule change, as amended, requires registered NASDAQ market makers to clear and settle securities transactions through a registered clearing agency when such facilities are within 25 miles of the market maker. The proposal includes several exceptions to this requirement, e.g., a market maker need not use a clearing agency if both parties to a trade agree to settle that trade “ex-clearing”. (Release No. 34-18689)