



United States
General Accounting Office
Washington, D.C. 20548

Office of the General Counsel

B-274403

September 26, 1996

The Honorable Alfonse D'Amato
Chairman
The Honorable Paul S. Sarbanes
Ranking Minority Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Thomas J. Bliley, Jr.
Chairman
The Honorable John D. Dingell
Ranking Minority Member
Committee on Commerce
House of Representatives

Subject: Securities and Exchange Commission: Rule 11AC1-4 (Limit Order Display Rule) and Amendments to Rule 11 AC1-1 (Quote Rule)

Pursuant to section 801(a)(2)(A) of title 5, United States Code, this is our report on Rule 11AC1-4 (Limit Order Display Rule) and Amendments to Rule 11 AC1-1 (Quote Rule) (RIN: 3235-AG66) promulgated by the Securities and Exchange Commission. We received the rule and amendments on September 9, 1996. They were published in the Federal Register on September 12, 1996. 61 Fed. Reg. 48290.

The Commission adopted the Limit Order Display Rule and amended the Quote Rule pursuant to its authority under the Securities Exchange Act of 1934, 15 U.S.C. § 78a-78ll.

The Limit Order Display Rule requires the public display of customer limit orders priced better than an exchange specialist's or market maker's quote. The rule also requires that specialists and market makers add limit orders priced at their quote to the size associated with their quote when that quote represents the best market-wide price. The rule will set standard display requirements for limit orders in all

markets. The rule represents a major change for the handling of limit orders in the Nasdaq market where such orders have never been displayed. The Commission believes that the new rule will benefit investors because the publication of trading interest at prices that improve specialists' and market makers' quotes presents investors with improved execution opportunities and improved access to best prices when they buy or sell securities.

The Commission also adopted amendments to its Quote Rule to ensure that all investors are fully informed of the best price at which specialists or market makers are willing to trade a security. Currently, specialists and market makers may privately display a better price than their public quotations through certain private trading systems in which priced orders are invisible and inaccessible to investors at large. The amendment to the rule benefits investors by bringing into public view the better prices in these systems and by allowing all investors to trade at these prices. In addition, the rule was amended to require that substantial market makers for any security listed on an exchange publish their quotations for that security. According to the Commission, this benefits investors by enhancing the public availability of prices for all listed securities, some of which were not published before.

Enclosed is our assessment of the Commission's compliance with the procedural steps required by sections 801(a)(1)(B)(i) through (iv) of title 5 with respect to the rule and amendments. Our review indicates that the Commission complied with the applicable requirements.

If you have any questions about this report, please contact Kathleen E. Wannisky, Associate General Counsel for Operations, at (202) 512-8326. The official responsible for GAO evaluation work relating to the Securities and Exchange Commission, is James L. Bothwell, Director, Financial Institutions and Markets Issues. Mr. Bothwell can be reached at (202) 512-8678.

Robert P. Murphy
General Counsel

Enclosure

cc: Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission

ENCLOSURE

ANALYSIS UNDER 5 U.S.C. §§ 801(a)(1)(B)(i)-(iv) OF RULE 11AC1-4 (LIMIT
ORDER DISPLAY RULE) AND AMENDMENTS TO RULE 11 AC1-1 (QUOTE RULE)
(RIN: 3235-AG66)
ISSUED BY
THE SECURITIES AND EXCHANGE COMMISSION

(i) Cost-benefit analysis

The Securities and Exchange Commission stated in its report to us that it was not required to prepare, and did not prepare, a cost-benefit analysis of the rule and rule amendments. Instead, pursuant to section 23(a)(2) of the Securities Exchange Act of 1934, 15 U.S.C. § 78w(a)(2), the Commission is directed to consider the impact that the rule may have on competition. The Commission stated that the competition analysis which it prepared provides information very similar to that provided by a cost-benefit analysis. The Commission concluded that the rule and rule amendments will not impose any unnecessary or inappropriate burdens on competition.

(ii) Agency actions relevant to the Regulatory Flexibility Act, 5 U.S.C. §§ 603-605, 607 and 609

Section 603: Initial Regulatory Flexibility Analysis

In its Notice of Proposed Rulemaking (60 Fed. Reg. 52792, October 10, 1995), the Commission included a summary of its Initial Regulatory Flexibility Analysis. In accordance with sections 603(b)(1) and (2), the Commission describes the reasons for the proposed agency actions and its objectives and legal basis. With regard to sections 603(b)(iii) and (iv), the Commission states that it uses certain Commission-adopted definitions of "small entities" for purposes of its analysis and concludes that it is unable to quantify reasonably the impact that the proposed rule and amendments would have on small dealers and brokers.

The summary of the Initial Regulatory Flexibility Analysis does not address any other relevant federal rules that duplicate, overlap, or conflict with this rule and amendments as provided for by section 603(b)(5).

Finally, the Commission rejected the alternative of exempting small entities from the proposed rules and amendments.

Section 604: Final Regulatory Flexibility Analysis

The Commission published a summary of its Final Regulatory Flexibility Analysis in the Federal Register on September 12, 1996 (61 Fed. Reg. 48325) and provided us with a copy of the full text of the analysis.

Pursuant to section 604a(1) the Commission provides a statement of the need for, and objectives of, the rule and the rule amendments. In accordance with section 604a(2), it provides a summary of the significant issues raised in the comments submitted in response to the Initial Regulatory Flexibility Analysis and its reaction to those comments. It specifically addresses concerns raised suggesting (1) that the Commission should better quantify the effects of the proposals on the market (especially the anti-competitive effects) and (2) that the Commission's estimates under the Paperwork Reduction Act (44 U.S.C. §§ 3501-3520) were too low. The Commission discusses how it amended the proposals in response to these comments.

The Commission discusses the two possible groups of small entities that would be subject to this rulemaking and concludes that as many as 100 broker-dealers and as many as 960 Nasdaq Small Cap issuers could be affected by this rulemaking.

The Commission describes the projected compliance requirements of the rules and describes the steps taken to minimize the economic impact on small entities, including consideration of several significant alternatives to both the Quote Rule and the Display Rule. The Commission states that it believes that the rule and amendments as adopted impose a smaller burden upon small brokers and dealers than any of the alternatives.

The Commission provides generally descriptive statements of the effects of the rules as suggested in section 607 of the Act.

The Commission has informed the GAO that to encourage small entities to participate in the rulemaking process as called for by section 609, it distributed a "plain English" version of the proposing release, it posted the proposals under the "Items of Interest to Small Businesses" section of its Internet Web-site, it met with groups that represent small businesses such as the security Traders Association and the New York Specialists Association, and its senior officials gave speeches describing the proposals and encouraging comments.

(iii) Agency actions relevant to sections 202-205 of the Unfunded Mandates Reform Act of 1995, 2 U.S.C. §§ 1532-1535

The Commission states in its report to us that the Unfunded Mandates Reform Act of 1995 does not apply to the Securities and Exchange Commission.

(iv) Other relevant information or requirements under Acts and Executive orders

Administrative Procedure Act, 5 U.S.C. §§ 551 et seq.

The Commission promulgated this rulemaking under the notice and comment procedures of 5 U.S.C. § 553. An initial Notice of Proposed Rulemaking was published in the Federal Register on October 10, 1995 (60 Fed. Reg. 52792). The Commission received comments on the proposals from 77 individual investors, 10 industry associations, seven exchanges, the National Association of Security Dealers, eight academics, 41 market participants, and the Department of Justice. The Commission discusses these comments and any actions taken in reaction to them in the supplementary information provided when the Final Rules were published in the Federal Register on September 12, 1996 (61 Fed. Reg. 48290-48332).

Paperwork Reduction Act, 44 U.S.C. §§ 3501-3520

According to the Commission, the proposed Display Rule and the proposed amendments to the Quote Rule contain collections of information within the meaning of the Paperwork Reduction Act. They were both submitted to the Office of Management and Budget (OMB) for review under section 3507 of the Act. They were both approved by OMB and assigned control numbers: control number 3235-0461 for the amendments to the Quote Rule and control number 3235-0462 for the Display Rule. An additional notice of information collection for the Quote Rule was published in the Federal Register on September 12, 1996 (61 Fed. Reg. 48333) proposing an additional amendment to the Quote Rule. OMB will make a decision regarding approval of this information collection between 30 and 60 days after publication in the Federal Register.

Statutory authorization for the rules

The Commission adopted the Limit Order Display Rule and amended the Quote Rule pursuant to its authority under the Securities Exchange Act of 1934 (15 U.S.C. § 78a-78ll), in particular pursuant to the mandate to develop a National Market System contained in Section 11A of the Act, 15 U.S.C. § 78k-1.

Other Executive Orders and Statutes

As discussed above, the Commission noted that the Securities Exchange Act of 1934 (15 U.S.C. § 78(a)(2)) requires the Commission to prepare an analysis of the effect of these rules on competition. Such an analysis was prepared. The Commission did not identify any other statutes or executive orders imposing requirements relevant to these rules.