

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-49547; File No. SR-NASD-2004-046)

April 9, 2004

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 thereto by National Association of Securities Dealers, Inc. Regarding SuperMontage Postable Auto-Ex Orders

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on March 16, 2004, the National Association of Securities Dealers, Inc. (“NASD”), through its subsidiary, The Nasdaq Stock Market, Inc. (“Nasdaq”), filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq. On April 2, 2004, Nasdaq filed Amendment No. 1 to the proposal.³ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of the Substance of the Proposed Rule Change

Nasdaq proposes to modify the Auto-Ex Order of the Nasdaq National Market Execution System (“NNMS” or “SuperMontage”). Pursuant to Section 19(b)(3)(A) of the Act⁴ and Rule 19b-4(f)(6) thereunder,⁵ Nasdaq has designated the proposed rule

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from John M. Yetter, Associate General Counsel, Nasdaq, to, Katherine England, Assistant Director, Division of Market Regulation (“Division”), Commission, dated April 1, 2004 (“Amendment No. 1”). In Amendment No. 1, Nasdaq clarified certain aspects of the description, proposed implementation date, and the rule text of the proposed rule change.

⁴ 15 U.S.C. 78s(b)(3)(A).

⁵ 17 C.F.R. 240.19b-4(f)(6).

change as non-controversial. Nasdaq intends to implement the proposed rule change on or about May 17, 2004,⁶ and will inform market participants of the exact implementation date via a Head Trader Alert on www.nasdaqtrader.com.

The text of the proposed rule change is below. Proposed new language is italicized; proposed deletions are in brackets.⁷

4700. NASDAQ NATIONAL MARKET EXECUTION SYSTEM (NNMS)

4701. Definitions

Unless stated otherwise, the terms described below shall have the following meaning:

(a) – (jj) No change.

(kk) The term “Auto-Ex” shall mean, for orders in Nasdaq listed securities so designated, an order that (except when it is displayed or interacts with a displayed Discretionary Order at a price in its discretionary price range) will execute solely against the Quotes/Orders of NNMS Participants that participate in the automatic execution functionality of the NNMS and that do not charge a separate quote access fee to NNMS Participants accessing their Quotes/Orders through the NNMS. An Auto-Ex Order may be designated as “Immediate or Cancel” (an “IOC Auto-Ex Order”) or “Day” or “GTC” (a “Postable Auto-Ex Order”). An NNMS Participant entering a Postable Auto-Ex Order

⁶ See Amendment No. 1, *supra* note 3.

⁷ The text of the proposed rule change is shown as marked against the text of the SuperMontage rules as published in Exhibit A to Securities Exchange Act Release No. 49349 (March 2, 2004), 69 FR 10775 (March 8, 2004) (SR-NASD-2004-149). It should be noted, however, that such Exhibit A contained a minor technical error, in that it did not accurately reflect the text of Amendment Nos. 2 and 3 to SR-NASD-2003-143, as approved by the Commission in Securities Exchange Act Release No. 49020 (January 5, 2004), 69 FR 1769 (January 12, 2004) (SR-NASD-2003-143). Accordingly, this proposed rule change includes several additions and deletions to restore changes made through Amendment Nos. 2 and 3 to SR-NASD-2003-143. See Amendment No. 1, *supra* note 3.

may (but is not required to) specify that the order will utilize the functionality associated with Discretionary Orders.

(ll) – (nn) No change.

(oo) Reserved.

(pp) – (uu) No change.

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4706. Order Entry Parameters

(a) Non-Directed Orders –

(1) General. The following requirements shall apply to Non-Directed Orders Entered by NNMS [Market] Participants:

(A) – (B) No change.

(1) – (3) No change.

(4) Starting at 7:30 a.m., until the 4:00 p.m. market close, IOC and Day Non-Directed Orders may be entered into NNMS (or previously entered orders cancelled), but such orders entered prior to market open will not become available for execution until 9:30 a.m. Eastern Time. GTC orders may be entered (or previously entered GTC orders cancelled) between the hours 7:30 a.m. to 6:30 p.m. Eastern Time, but such orders entered prior to market open, or GTC orders carried over from previous trading days, will not become available for execution until 9:30 a.m. Eastern Time. Exception: For Nasdaq listed securities only, Non-Directed Day (other than Pegged, Postable Auto-Ex, and Discretionary Orders)

and GTC orders (other than Postable Auto-Ex Orders) may be executed prior to market open if required under Rule 4710(b)(3)(B).

(5) [f]For Nasdaq listed securities, an order may be designated as “Auto-Ex,” in which case the order may [will also automatically] be designated as IOC[.], Day or GTC. [An Auto-Ex Order will execute solely against the Quotes/Orders of NNMS Participants at the best bid/best offer that participate in the automatic execution functionality of the NNMS and that do not charge a separate quote-access fee to NNMS Participants accessing their Quotes/Orders through the NNMS.] If an NNMS Participant entering a Postable Auto-Ex Order specifies that the order will utilize the functionality associated with Discretionary Orders, the order will automatically be designated as Day.

(6) – (12) No change.

(C) – (E) No change.

(F) An NNMS [Market] Participant may enter a Non-Directed Order that is either a market order or a limit order prior to the market’s open. Market orders and limit orders designated as Immediate or Cancel, [and] limit orders designated as Total Immediate or Cancel, Auto-Ex Orders, and Discretionary Orders whose displayed price or discretionary price range would lock or cross another Quote/Order if they were displayed orders shall be held in a time-priority queue that will begin to be

processed by NNMS at market open. If an Immediate or Cancel limit order is unmarketable at the time it reaches the front of the time-priority processing queue, it will be returned to the entering market participant. Limit orders that are not designated as Immediate or Cancel orders shall be retained by NNMS for potential display in conformity with Rule 4707(b) and/or potential execution in conformity with Rule 4710(b)(1)(B).

(2) Entry of Non-Directed Orders by NNMS Order Entry Firms – In addition to the requirements in paragraph (a)(1) of this rule, the following conditions shall apply to Non-Directed Orders entered by NNMS Order Entry Firms:

(A) (i) All Non-Directed orders in Nasdaq listed securities shall be designated as Immediate or Cancel, GTC or Day but shall be required to be entered as Non-Attributable if not entered as IOC. NNMS Order Entry Firms may designate orders as “Pegged” or “Discretionary,” in which case the order will also automatically be designated as Day. NNMS Order Entry Firms may also designate orders as “Auto-Ex,” in which case the order may be designated as IOC, Day or GTC. If an NNMS Order Entry Firm entering a Postable Auto-Ex Order specifies that the order will utilize the functionality associated with Discretionary Orders, the order will automatically be designated as Day. For IOC orders, if after entry into the NNMS of a Non-Directed Order that is marketable, the order (or the unexecuted portion thereof) becomes non-marketable, the system will return the order (or unexecuted portion thereof) to the entering participant.

(ii) No change.

(B) A Non-Directed Order that is either a market or limit order may be entered prior to the market's open. Limit and market orders designated as Immediate or Cancel or, in the case of ITS Securities, IOX, Auto-Ex Orders, and Discretionary Orders [or, in the case of ITS Securities, IOX,] whose displayed price or discretionary price range would lock or cross another Quote/Order if they were displayed will be held in a time-priority queue that will begin to be processed at market open. A limit order that is designated as IOC or, in the case of ITS Securities, IOX₂ and that is not marketable at the time it reaches the front of the time-priority processing queue will be returned to the entering participant.

(b) – (e) No change.

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4710. Participant Obligations in NNMS

(a) No change.

(b) Non-Directed Orders

(1) No change.

(A) No change.

(B) No change.

(i) No change.

(ii) Exceptions – The following exceptions shall apply to the above execution parameters:

a. – c. No change.

[(d)] d. An Auto-Ex O[order] in a Nasdaq listed security that is designated IOC will [execute] interact solely [against] with the Quotes/Orders of NNMS Participants [at the best bid/best offer] that participate in the automatic execution functionality of the NNMS and that do not charge a separate quote-access fee to NNMS Participants accessing their Quotes/Orders through the NNMS (“Auto-Ex Eligible Participants”). An IOC Auto-Ex Order will not interact with the Quote/Order of an Auto-Ex Eligible Participant if the Quote/Order of an NNMS Participant that is not an Auto-Ex Eligible Participant is priced better than the Quote/Order of any Auto-Ex Eligible Participant at that time. An IOC Auto-Ex O[order] (or an unexecuted portion thereof) will be cancelled if it cannot be immediately executed.

Upon entry into the NNMS, a Postable Auto-Ex Order will be processed in the same manner as an IOC Auto-Ex Order; provided, however, that if the Postable Auto-Ex Order includes discretionary prices, the order will be processed in the same manner as a Discretionary Order, but will interact solely with the Quotes/Orders of Auto-Ex Eligible Participants and will not interact with the Quote/Order of an Auto-Ex Eligible Participant if the Quote/Order of an

NNMS Participant that is not an Auto-Ex Eligible Participant is priced better than the Quote/Order of any Auto-Ex Eligible Participant at that time. Any portion of a Postable Auto-Ex Order that cannot be immediately executed will be displayed, unless it would lock or cross the Quote/Order of an NNMS Participant that is not an Auto-Ex Eligible Participant, in which case the Postable Auto-Ex Order (or any unexecuted portion thereof) will be cancelled. Depending on the functionality specified by the NNMS Participant entering the order, a Postable Auto-Ex Order that is displayed will have the same characteristics and be subject to the same rules as a regular limit order or a Discretionary Order.

For purposes of this subclause d., any displayed Discretionary Order that may be executed against (or delivered to) an Auto-Ex Order at a price in the Discretionary Order's discretionary price range will be deemed to have been entered by an Auto-Ex Eligible Participant.

e. No change.

(C) – (D) No change.

(2) – (8) No change.

(c) – (e) No change.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, Nasdaq included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. Nasdaq has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The Commission recently approved a new SuperMontage order type, known as the Auto-Ex Order,⁸ which executes solely against the Quotes/Orders of SuperMontage participants that participate in the system’s automatic execution functionality and that do not charge a separate quote-access fee to participants accessing their Quotes/Orders through SuperMontage (“Auto-Ex Eligible Participants”). Auto-Ex Orders access liquidity available at multiple price levels, but do not “trade through” the Quote/Order of an Order-Delivery ECN (or an auto-ex ECN that charges an access fee). Thus, an Auto-Ex Order is now automatically designated Immediate or Cancel (“IOC”), and the order (or any unexecuted portion thereof) is cancelled whenever the best price available through SuperMontage solely reflects the Quote/Order of a market participant that is not eligible to receive the Auto-Ex Order.

⁸ See Securities Exchange Act Release No. 49020 (January 5, 2004), 69 FR 1769 (January 12, 2004) (SR-NASD-2003-143).

Nasdaq is proposing to provide market participants with the option of designating Auto-Ex Orders as “Day” or “Good-till-Cancelled” orders (“Postable Auto-Ex Orders”). A Postable Auto-Ex Order would initially be processed in the same manner as an IOC Auto-Ex Order. Once all liquidity available from Auto-Ex Eligible Participants has been accessed, the order may then be eligible for display. However, the order will be cancelled, rather than displayed, if its price would lock or cross the Quote/Order of a market participant that is not an Auto-Ex Eligible Participant. For example, if the best offer in Nasdaq was \$20.05 and a market participant entered a Day Auto-Ex Order to buy at \$20.05, the order would access all liquidity offered by Auto-Ex Eligible Participants at \$20.05, and if there was no offer at that price level from a market participant that was not an Auto-Ex Eligible Participant, the order (or unexecuted portion thereof) would be displayed at \$20.05. However, if an Order-Delivery ECN (or an auto-ex ECN that charges an access fee) had an offer at \$20.05 displayed in SuperMontage, the Postable Auto-Ex Order (or unexecuted portion thereof) would be cancelled, because it would lock the ECN’s offer if it were displayed. Once a Postable Auto-Ex Order is displayed as a Quote/Order, it may interact with trading interest entered by any NNMS Participant, including participants that are not Auto-Ex Eligible Participants.

Postable Auto-Ex Orders may be entered (but not displayed or executed) prior to market open. Such orders will be held in a time-priority queue (along with IOC orders and executable Discretionary Orders) and processed by the NNMS at 9:30. Nasdaq believes that this limitation on the use of Postable Auto-Ex Order functionality in the period before the market open is logical, since automatic executions are not available before 9:29:30 in any event. If Postable Auto-Ex Orders entered before this time were

not queued, they would, in almost all circumstances, be processed like regular Day or Good-Till-Cancelled orders; accordingly, Nasdaq expects that there would be little use of the order type prior to 9:30 if the order were displayable in the period before the market open.⁹ By queuing Postable Auto-Ex Orders entered before 9:30, Nasdaq will allow market participants to obtain rapid executions at market open, followed by the immediate cancellation or posting of size that cannot be immediately executed.

The Postable Auto-Ex Order can be combined with the functionality associated with Discretionary Orders. Such an order will be processed like a regular Discretionary Order prior to posting, except that it will not be delivered to the Quotes/Orders of Order-Delivery ECNs (or access-fee charging ECNs). Like a regular Auto-Ex Order, however, the order may not execute at a price worse than a price available from an Order-Delivery (or access fee-charging) ECN, and would cancel if it could not be posted without locking or crossing such an ECN. Accordingly, since a Discretionary Order seeks to execute at multiple prices before posting, a Postable Auto-Ex Order with discretionary prices would be more likely to cancel prior to posting than a Postable Auto-Ex Order with a single price. If, however, the order can be posted, it will be subject to the same terms and conditions as any other Discretionary Order after it is posted.

The filing also clarifies the manner in which an Auto-Ex Order may interact with a displayed Discretionary Order. Specifically, because a displayed Discretionary Order that is executable at a price in its discretionary price range is executed automatically or delivered based on the status of its potential contra party, rather than the status of the participant that entered the order, the Discretionary Order may execute against (or be

⁹ See Amendment No. 1, *supra* note 3.

delivered to) an incoming Auto-Ex Order even if the Discretionary Order was not posted by an Auto-Ex Eligible Participant. By contrast, if the Auto-Ex Order is executable against a Discretionary Order at its displayed price, the extent to which the orders may interact depends on whether the participant that entered the Discretionary Order is an Auto-Ex Eligible Participant.

2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 15A of the Act,¹⁰ in general, and with Section 15A(b)(6) of the Act,¹¹ in particular, in that it is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. The proposed rule change will provide market participants with a voluntary tool that will allow them to access liquidity available through SuperMontage quickly and at a low cost and subsequently to offer liquidity.

B. Self-Regulatory Organization's Statement on Burden on Competition

Nasdaq does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

¹⁰ 15 U.S.C. 78q-3.

¹¹ 15 U.S.C. 78q-3(b)(6).

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Act,¹² and subparagraph (f)(6) of Rule 19b-4,¹³ thereunder because it does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate. At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.¹⁴

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Comments should be submitted electronically at the following e-mail address: rule-comments@sec.gov. All comment letters should refer to File No. SR-NASD-2004-046. This file number should be included on the subject line if

¹² 15 U.S.C. 78s(b)(3)(A).

¹³ 17 CFR 240.19b-4(f)(6).

¹⁴ For the purposes of calculating the 60-day abrogation period, the Commission considers the proposed rule change to have been filed on April 2, 2004, the date Nasdaq filed Amendment No. 1.

e-mail is used. To help the Commission process and review your comments more efficiently, comments should be sent in hard copy or by e-mail but not by both methods. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR-NASD-2004-046 and should be submitted by [insert date 21 days from the date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁵

Margaret H. McFarland
Deputy Secretary

¹⁵ 17 CFR 200.30-3(a)(12).