

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-49650; File No. SR-NASD-2004-064)

May 4, 2004

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Inc. Regarding Technical Corrections to SuperMontage Rules

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 April 15, 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 Nasdaq has prepared. Pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(3) thereunder,³ Nasdaq has designated this proposal as one concerned solely with the administration of the self-regulatory organization, which renders the rule effective upon the Commission's receipt of this filing. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

Nasdaq proposes to make technical corrections to the rules governing the operation of the Nasdaq National Market Execution System ("NNMS" or "SuperMontage"). The text of the proposed rule change is set forth below. Proposed new language is in *italics*; proposed deletions are in [brackets].

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¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 17 CFR 240.19b-4(f)(3).

4700. NASDAQ NATIONAL MARKET EXECUTION SYSTEM (NNMS)

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4701. Definitions

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

(a) through (ll) **No Change.**

(mm) The term “Pegged” shall mean, for priced limit orders so designated, that after entry into the NNMS, the price of the order is automatically adjusted by NNMS in response to changes in the Nasdaq inside bid or offer, as appropriate. [The price of a Pegged Order may be equal to the inside quote on the same side of the market (a Regular Pegged Order) or may be equal to a specified amount better than the inside quote on the contra side of the market (a Reverse Pegged Order).] The NNMS Participant entering a Pegged Order may specify that the price of the order will either equal the inside quote on the same side of the market (a “Regular Pegged Order”) or equal a price that deviates from the inside quote on the contra side of the market by \$0.01 (i.e., \$0.01 less than the inside offer or \$0.01 more than the inside bid) (a “Reverse Pegged Order”). The market participant entering a Pegged Order may (but is not required to) specify a cap price, to define a price at which pegging of the order will stop and the order will be permanently converted into an un-pegged limit order. Pegged Orders shall not be available for ITS Securities.

(nn) through (uu) **No Change.**

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4705. NNMS Participant Registration

(a) Participation in NNMS as an NNMS Market Maker requires current registration as such with the Association. Such registration shall be conditioned upon the

NNMS Market Maker's initial and continuing compliance with the following requirements:

(1) **No Change.**

(2) membership in, or access arrangement with a participant of, a clearing agency registered with the Commission that maintains facilities through which NNMS compared trades may be settled;

(3) **No Change.**

(4) maintenance of the physical security of the equipment located on the premises of the NNMS Market Maker [or] to prevent the improper use or access to Nasdaq systems, including unauthorized entry of information into NNMS; and

(5) **No Change.**

(b) through (c) **No Change.**

(d) Participation in NNMS as an NNMS ECN requires current registration as an NASD member and shall be conditioned upon the following:

(1) through (2) **No Change.**

(3) membership in, or access arrangement with a participant of, a clearing agency registered with the Commission [which] that maintains facilities through which NNMS-compared trades may be settled;

(4) through (5) **No Change.**

(e) through (h) **No Change.**

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4706. Order Entry Parameters

(a) **No Change.**

(b) Directed Orders in Nasdaq-listed Securities. A participant may enter a Directed Order in a Nasdaq-listed security into the NNMS to access a specific Attributable Quote/Order displayed in the Nasdaq Quotation Montage, subject to the following conditions and requirements:

(1) Unless the Quoting Market Participant to which a Directed Order is being sent has indicated that it wishes to receive Directed Orders that are Liability Orders, a Directed Order must be a Non-Liability Order, and as such, at the time of entry must be designated as:

(A) through (B) **No Change.**

(C) a Directed Order that is entered at a price that is inferior to the Attributable Quote/Order of the Quoting Market Participant to which the order is directed. [Nasdaq will append an indicator to the quote of a Quoting Market Participant that has indicated to Nasdaq that it wishes to receive Directed Orders that are Liability Orders.]

(2) through (5) **No Change.**

(c) through (e) **No Change.**

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4710. Participant Obligations in NNMS

(a) Registration – Upon the effectiveness of registration as a NNMS Market Maker, NNMS ECN, ITS/CAES Market Maker or NNMS Order Entry Firm, the NNMS Participant may commence activity within NNMS for exposure to orders or entry of orders, as applicable. The operating hours of NNMS may be established as appropriate by the Association. The extent of participation in Nasdaq by an NNMS Order Entry Firm

shall be determined solely by the firm in the exercise of its ability to enter orders into Nasdaq.

(b) Non-Directed Orders

(1) General Provisions--A Quoting Market Participant in an NNMS Security, as well as NNMS Order Entry Firms, shall be subject to the following requirements for Non-Directed Orders:

(A) Obligations = [f]For each NNMS security in which it is registered, a Quoting Market Participant must accept and execute individual Non-Directed Orders against its quotation, in an amount equal to or smaller than the combination of the Displayed Quote/Order and Reserve Size (if applicable) of such Quote/Order, when the Quoting Market Participant is at the best bid/best offer in Nasdaq. This obligation shall also apply to the Non-Attributable Quotes/Orders of NNMS Order Entry Firms. Quoting Market Participants, and NNMS Order Entry Firms, shall participate in the NNMS as follows:

(i) through (iv) **No Change.**

(B) Processing of Non-Directed Orders--Upon entry of a Non-Directed Order into the system, the NNMS will ascertain who the next Quoting Market Participant or NNMS Order Entry Firm in queue to receive an order is and shall deliver an execution to Quoting Market Participants or NNMS Order Entry Firms that participate in the automatic-execution functionality of the system, or shall deliver a Liability Order to Quoting Market Participants that participate in the order-delivery functionality of

the system. Non-Directed Orders entered into the NNMS system shall be delivered to or automatically executed against Quoting Market Participants' or NNMS Order Entry Firms' Displayed Quotes/Orders and Reserve Size, in strict price/time priority, as described in the algorithm contained in subparagraph (b)(B)(i) of this rule. The individual time priority of each Quote/Order submitted to NNMS shall be assigned by the system based on the date and time such Quote/Order was received. Reminders of Quote/Orders reduced by execution, if retained by the system, shall retain the time priority of their original entry. For purposes of the execution algorithm described below, "Displayed Quotes/Orders" shall also include any odd-lot, odd-lot portion of a mixed-lot, or any odd-lot remainder of a round-lot(s) reduced by execution, share amounts that while not displayed in the Nasdaq Quotation Montage, remain in system and available for execution.

(i) **No Change.**

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

a. through e. **No Change.**

[(f)] f. A Fill or Return order in an ITS Security will be executed solely by the NNMS at the best bid/best offer, without delivering the order to an ITS Exchange. The NNMS will, if necessary, execute against interest at successive price levels.

(C) Decrementation Procedures--The size of a Quote/Order displayed in the Nasdaq Order Display Facility and/or the Nasdaq Quotation Montage will be decremented upon the delivery of a Liability Order or the delivery of an execution of a Non-Directed Order or Preferred Order in an amount equal to the system-delivered order or execution.

(i) **No Change.**

(ii) If an NNMS Order-Delivery ECN declines or partially fills a Non-Directed Order without immediately transmitting to Nasdaq a revised Attributable Quote/Order that is at a price inferior to the previous price, or if an NNMS Order-Delivery ECN fails to respond in any manner within 30 seconds of order delivery, the system will cancel the delivered order and send the order (or remaining portion thereof) back into the system for immediate delivery to the next [Quoting Market Participant] eligible Quote/Order in queue. The system then will zero out [the] those ECN[’s] Quote/Orders to which the Non-Directed Order was delivered. [at that price level on that side of the market,] If there are no other Quote/Orders at the declined price level, [and] the ECN's quote on that side of the market will remain at zero until the ECN transmits to Nasdaq a revised Attributable Quote/Order. If both the bid and offer are zeroed out, the ECN will be placed into an excused withdrawal state until the ECN transmits to Nasdaq a revised Attributable Quote/Order.

(iii) through (v) **No Change.**

(D) **No Change.**

(2) Refresh Functionality

(A) Reserve Size Refresh--Once a Nasdaq Quoting Market Participant's or NNMS Order Entry Firm's Displayed Quote/Order size on either side of the market in the security has been decremented to an amount less than one normal unit of trading due to NNMS processing, Nasdaq will refresh the displayed size out of Reserve Size to a size-level designated by the Nasdaq Quoting Market Participant or NNMS Order Entry Firm, or in the absence of such size-level designation, to the automatic refresh size. The amount of shares taken out of reserve to refresh display size shall be added to any shares remaining in the Displayed Quote/Order and shall be of an amount that when combined with the number of shares remaining in the Nasdaq Quoting Market Participant's Displayed Quote/Order before it is refreshed will equal the displayed size-level designated by the Nasdaq Quoting Market Participant or, in the absence of such size-level designation, to the automatic refresh size. If there are insufficient shares available to produce a Displayable Quote/Order, the Nasdaq Quoting Market Participant's Quote/Order, and any odd-lot remainders, will be refreshed, updated, or retained, in conformity with NNMS Rules 4707 and 4710 as appropriate. To utilize the Reserve Size functionality, a minimum of 100 shares must initially be displayed in the Nasdaq Quoting Market Participant's or NNMS Order Entry Firm's Displayed Quote/Order, and the Displayed Quote/Order must be

refreshed to at least 100 shares. This functionality will not be available for use by UTP Exchanges.

(B) **No Change.**

(3) through (8) **No Change.**

(c) through (e) **No Change.**

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4715. Adjustment of Open Quotes and/or Orders

NNMS will automatically adjust the price and/or size of open quotes and/or orders in all NNMS securities (unless otherwise noted) resident in the system in response to issuer corporate actions related to a dividend, payment or distribution, on the ex-date of such actions, except where a cash dividend or distribution is less than one cent (\$0.01), as follows:

(a) through (b) **No Change.**

(c) Buy Orders--Buy side orders shall be adjusted by the system based on the particular corporate action impacting the security (i.e. cash dividend, stock dividend, both, stock split, reverse split) as set forth below:

(1) through (3) **No Change.**

(4) Dividends Payable in Either Cash or Securities at the Option of the Stockholder: Buy side order prices shall be reduced by the dollar value of either the cash or securities, whichever is greater. The dollar value of the cash shall be determined using the formula in paragraph ([1] 2) above, while the dollar value of the securities shall be determined using the formula in paragraph ([2] 3) above. If the stockholder opts to

receive securities, the size of the order shall be increased pursuant to the formula in subparagraph ([2] 3) above.

(5) Combined Cash and Stock Dividends/Split: In the case of a combined cash dividend and stock split/dividend, the cash dividend portion shall be calculated first as per section ([1] 2) above, and stock portion thereafter pursuant to sections ([2] 3) and/or ([3] 4) above.

(6) **No Change.**

(d) **No Change.**

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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

On March 2, 2004, the Commission approved Nasdaq's proposal to transition the trading of exchange-listed securities onto the SuperMontage trading platform from the Computer Assisted Execution System. The text of the SuperMontage rules approved as part of that proposal, filed as Exhibit A to that proposal ("Exhibit A"), contained minor

technical errors as published.⁴ Exhibit A did not accurately reflect some of the text of several NASD rule proposals that had previously been approved by the Commission and were in effect.⁵

Specifically, Exhibit A did not accurately reflect some of the text of SR-NASD-2003-81 and Amendment No. 1 thereto, as approved by the Commission.⁶ That proposal modified NASD Rule 4710(b)(1)(C)(ii) to change how the quotes of order-delivery Electronic Communication Networks in SuperMontage are decremented after they decline an order shipped to them. Some of those approved changes were inadvertently omitted from Exhibit A and are being restored by this proposed rule change.

Exhibit A also did not accurately reflect the text of Amendment No. 3 to SR-NASD-2003-85, as approved by the Commission.⁷ Amendment No. 3, among other things, made non-substantive changes to NASD Rule 4705 to reflect that indirect participation in a clearing agency occurs through a ‘participant,’ as such term is defined in Section 3(a)(24) of the Act. That approved change was inadvertently omitted from Exhibit A and is being restored by this proposed rule change. Exhibit A also did not

⁴ See Securities Exchange Act Release No. 49349 (March 2, 2004), 69 FR 10775 (March 8, 2004) (“Exhibit A”).

⁵ One of these omissions, the omission of text from Amendments 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) was corrected in Securities Exchange Act Release No. 49547 (April 9, 2004), 69 FR 20091 (SR-NASD-2004-46).

⁶ See Securities Exchange Act Release No. 48434 (September 3, 2003), 68 FR 53409 (September 10, 2003).

⁷ See Securities Exchange Act Release No. 48527 (September 23, 2003), 68 FR 56361 (September 30, 2003).

accurately reflect the text of SR-NASD-2003-150, as approved by the Commission.⁸ Specifically, SR-NASD-2003-150 modified NASD Rule 4701(mm) to create a new order type called a Pegged Order. Several of those approved changes are being restored through this proposed rule change.

Lastly, the proposed rule change also makes numbering and other non-substantive rule modifications.

2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 15A of the Act,⁹ in general and with Section 15A(b)(6) of the Act,¹⁰ in particular, in that the proposal is designed to prevent fraudulent and manipulative acts and practices, 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.

Nasdaq believes the proposed rule change is consistent with the Act, for the same reasons that the proposed rule changes were consistent with the Act when originally filed.

According to Nasdaq, in approving SR-NASD-2003-81, the Commission found that the

⁸ See Securities Exchange Act Release No. 48798 (November 17, 2003), 68 FR 66147 (November 25, 2003).

⁹ 15 U.S.C. 78o-3.

¹⁰ 15 U.S.C. 78o-3(b)(6). Nasdaq originally stated that the filing was consistent with Section 15A(b)(3), but corrected the statutory reference. Telephone conversation between Thomas Moran, Associate General Counsel, Nasdaq, and Elizabeth MacDonald, Attorney, Division of Market Regulation (“Division”), Commission, April 21, 2004.

proposed quote decrementation procedure was consistent with the Act in that it is designed to produce fair and informative quotations, to prevent fictitious or misleading quotations, and to promote orderly procedures for collecting, distributing, and publishing quotations. In approving SR-NASD-2003-85, according to Nasdaq, the Commission found that post-trade¹¹ anonymity is consistent with the Act and has been available in different forms for many years. As Nasdaq noted in SR-NASD-2003-150, the Pegged Order is consistent with the Act in that it provides market participants with a voluntary tool to use to offer liquidity at the inside market in Nasdaq.

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

The NASD does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the Act.

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

The NASD neither solicited nor received written comments on this proposal.

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

The forgoing rule change has become effective upon filing with the Commission pursuant to Section 19(b)(3)(A) of the Act,¹² in that it is concerned solely with the administration of the self-regulatory organization.

¹¹ Nasdaq corrected an error to the text, which formerly read “pre-trade.” Telephone conversation between Thomas Moran, Associate General Counsel, Nasdaq, and Elizabeth MacDonald, Attorney, Division, Commission, May 3, 2004.

¹² 15 U.S.C. 78s(b)(3)(A).

At any time within 60 days after the filing of the proposed rule change, the Commission may summarily abrogate the 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.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASD-2004-064 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-NASD-2004-064. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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 Section, 450 Fifth Street, NW, Washington, DC 20549-0609. Copies of such filing also will be available for inspection and copying at the principal office of the NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2004-064 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹³

Margaret H. McFarland
Deputy Secretary

¹³ 17 CFR 200.30-3(a)(12).