

the vast majority of which enter orders for less than seventy-five contracts—by making the RAES system less reliable.

Finally, the Commission finds good cause for approving Amendment No. 1 prior to the 30th day after notice of the Amendment is published in the **Federal Register** pursuant to section 19(b)(2) of the Act.²⁴ Amendment No. 1 makes technical changes to the proposed rule text to reflect changes to Interpretation .03 to Rule 8.51 made in the filing of the proposed change. In addition, Amendment No. 1 clarifies that the DPM or another member of the trading crowd may determine to reflect the price of a market maker or other proprietary broker-dealer order in the displayed quote, even if that order is for less than the firm quote requirement (in the case of broad-based index options) or if the order is for less than ten contracts (in the case of all other option contracts.)²⁵ The Commission believes that the proposal may increase price transparency at the Exchange by expanding the kinds of orders eligible to be reflected in the Exchange's displayed quote. The Commission finds that accelerated approval of Amendment No. 1 is appropriate in order to permit the opportunity for increased transparency for market-maker orders or other proprietary broker-dealer orders.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1, including whether it 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. 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 CBOE. All submissions should refer to File No. SR-CBOE-99-51 and should be submitted by December 6, 2000.

Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with section 6(b)(5).²⁶

It Is Therefore Ordered, pursuant to section 19(b)(2) of the Act,²⁷ that the proposed rule change (SR-CBOE-51) is approved, and Amendment No. 1 is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁸

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 00-29187 Filed 11-14-00; 8:45 am]

BILLING CODE 8010-01-M

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43514; No. SR-NASD-99-53]

Self-Regulatory Organizations; Notice of Filing of Amendment No. 8 to Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to the Establishment of Nasdaq Order Display Facility and to Modifications of the Nasdaq Trading Platform

November 3, 2000.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19(b)(4) thereunder,² notice is hereby given that on October 23, 2000, the National Association of Securities Dealers, Inc. ("NASD"), through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("SEC" or "Commission") Amendment No. 8 to the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the NASD.³ The proposed rule change and Amendment Nos. 1 and 2 were published for comment in the **Federal Register** on December 6, 1999.⁴

²⁶ 15 U.S.C. 78f(b)(5).

²⁷ 15 U.S.C. 78s(b)(2).

²⁸ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Exhibit 3 to Amendment No. 8 contains a summary of how the NASD intends that the SuperMontage will operate. The summary incorporates and reconciles the original rule proposal and the subsequent proposed amendments, including Amendment No. 8. Exhibit 3 is available for public inspection in the Commission's Public Reference Room.

⁴ See Securities Exchange Act Release No. 42166 (Nov. 22, 1999), 64 FR 69125.

On March 16, 2000, the NASD filed Amendment No. 3 to the proposal.⁵ On March 30, 2000, Amendment No. 4 was published for comment in the **Federal Register**.⁶ On May 16, 2000, the NASD filed Amendment No. 5 to the proposal.⁷ On July 6, 2000, the NASD filed Amendment No. 6 to the proposal.⁸ On August 7, 2000, the NASD filed Amendment No. 7 to the proposal.⁹ On August 15, 2000 Amendment Nos. 5, 6, and 7 were published for comment in the **Federal Register**.¹⁰ The Commission is publishing this notice to solicit comments on Amendment No. 8 from interested persons.

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

The NASD, through its subsidiary Nasdaq, is filing substantive and technical amendments to File No. SR-NASD-99-53, which proposes to establish the Nasdaq Order Display Facility ("NODF") and make changes to the Nasdaq National Market System ("NNMS").¹¹ Because the NASD is proposing alternative approaches to preferred orders, there are two versions of the proposed rule text reflecting Alternative A and Alternative B. Except for the provisions relating to

⁵ See letter from Richard G. Ketchum, President, NASD, to Belinda Blaine, Associate Director, Division of Market Regulation ("Division"), Commission (March 15, 2000) ("Amendment No. 3"). In Amendment No. 3, the NASD responded to comment letters and submitted substantive, clarifying, and technical amendments to the proposal.

⁶ See Securities Exchange Act Release No. 42573 (March 23, 2000), 65 FR 16981 ("Amendment No. 4").

⁷ See Letter from Richard G. Ketchum, President, NASD, to Belinda Blaine, Associate Director, Division, Commission (May 16, 2000) ("Amendment No. 5").

⁸ See letter from Richard G. Ketchum, President, NASD, to Belinda Blaine, Associate Director, Division, Commission (July 6, 2000) ("Amendment No. 6").

⁹ See letter from Richard G. Ketchum, President, NASD, to Belinda Blaine, Associate Director, Division, Commission (August 7, 2000) ("Amendment No. 7").

¹⁰ See Securities Exchange Act Release No. 43133 (August 10, 2000), 65 FR 149842 ("August 15, 2000 Notice").

¹¹ The amended rule language contained in this notice reflects the Commission's approval of SR-NASD-99-11, regarding the establishment of the Nasdaq National Market System ("NNMS"). See Securities Exchange Act Release No. 42344 (January 14, 2000), 65 FR 3987 (January 25, 2000) (Order for File No. SR-NASD-99-11 functionally integrating the Small Order Execution System ("SOES") and SelectNet system to become the foundation of the NNMS). In addition, the amended rule language replaces, in the entirety, the rule language contained in the original filing, as well as Amendment Nos. 1 through 7.

²⁴ 15 U.S.C. 78s(b)(2).

²⁵ See Amendment No. 1, *supra* note 4.

preferred orders, Alternative A and Alternative B are identical.

A. *Proposed Rule Language for File No. NASD-99-53 containing Alternative A.* Proposed additions are *italicized* and proposed deletions are placed in [brackets].

4720. SelectNet Service—Deleted

* * * * *

4611. Registration as a Nasdaq Market Maker

(a)–(e) No Change.

(f) Unless otherwise specified by the Association, each Nasdaq market maker that is registered as a market maker in a Nasdaq[National Market security]-*listed security* shall also at all times be registered as a market maker in the Nasdaq National Market Execution System (NNMS) with respect to that security and be subject to the NNMS Rules as set forth in the Rule 4700 Series. [Participation in the Small Order Execution System (SOES) shall be voluntary for any Nasdaq market maker registered to make a market in a Nasdaq SmallCap security.]

(g) No Change.

* * * * *

4613. Character of Quotations

(a) Two-Sided Quotations

(1) For each security in which a member is registered as a market maker, the member shall be willing to buy and sell such security for its own account on a continuous basis and shall enter and maintain a two-sided quotation[s] (*“Principal Quote”*), which is attributed to the market maker by a special maker participant identifier (*“MMID”*) and is displayed in the Nasdaq Quotation Montage [in The Nasdaq Stock Market] at all times, subject to the procedures for excused withdrawal set forth in Rule 4619.

(A) A registered market maker in a Nasdaq-listed security [listed on The Nasdaq Stock Market] must display a quotation size for at least one normal unit of trading (or a larger multiple thereof) when it is not displaying a limit order in compliance with SEC Rule 11Ac1-4, provided, however, that a registered market maker may augment its displayed quotation size to display limit orders priced at the market maker's quotation. *Unless otherwise designated, a “normal unit of trading” shall be 100 shares.*

(b) Agency Quote—Amendments Pending Pursuant to SR-NASD-99-09.

(c)–(e) No Change.

IM-4613. Autoquote Policy—No Change

4618. Clearance and Settlement

(a)–(b) No Changes.

(c) All transactions through the facilities of the Nasdaq National Market Execution System[, SOES, and SelectNet services] shall be cleared and settled through a registered clearing agency using a continuous net settlement system.

* * * * *

4619. Withdrawal of Quotations and Passive Market Making

(a)–(b) No Change.

(c) Excused withdrawal status may be granted to a market maker that fails to maintain a clearing arrangement with a registered clearing agency or with a member of such an agency and is withdrawn from participation in the Automated Confirmation Transaction service, thereby terminating its registration as a market maker in Nasdaq issues. Provided however, that if the Association finds that the market maker's failure to maintain a clearing arrangement is voluntary, the withdrawal of quotations will be considered voluntary and unexcused pursuant to Rule 4620[, the Rules for the Small Order Execution System, as set forth in the Rule 4750 Series,] and the Rule 4700 Series governing the Nasdaq[s] National Market Execution System.

(d) No Change.

* * * * *

4620. Voluntary Termination of Registration

(a) A market maker may voluntarily terminate its registration in a security by withdrawing its *Principal* [quotations] *Quote* from The Nasdaq Stock Market. A market maker that voluntarily terminates its registration in a security may not re-register as a market maker in that security for twenty (20) business days. Withdrawal from participation as a market maker in a Nasdaq [National Market]-*listed security* in the Nasdaq National Market Execution System shall constitute termination of registration as a market maker in that security for purposes of this Rule; provided, however, that a market maker that fails to maintain a clearing arrangement with a registered clearing agency or with a member of such an agency and is withdrawn from participation in the Automated Confirmation Transaction System and thereby terminates its registration as a market maker in Nasdaq-listed [National Market and SmallCap] issues may register as a market maker at any time after a clearing arrangement has been reestablished and the market maker has

complied with ACT participant requirements contained in Rule 6100.

* * * * *

4632. Transaction Reporting

(a)–(d) No Change.

(e) Transactions Not Required To Be Reported

The following types of transactions shall not be reported:

(1) Transactions executed through the Computer Assisted Execution System (CAES), or the facilities of the Nasdaq National Market Execution System (*“NNMS”*)[, or the SelectNet service];

(2)–(6) No Change.

(f) No Change.

4642. Transaction Reporting

(a)–(d) No Change.

(e) Transactions Not Required To Be Reported

The following types of transactions shall not be reported:

(1) Transactions executed through the Computer Assisted Execution System (CAES)[; the Small Order Execution System (SOES) or the SelectNet service] or facilities of the Nasdaq National Market Execution System (*“NNMS”*).

(2)–(5) No Change.

(f) No Change.

* * * * *

4700. NASDAQ NATIONAL MARKET EXECUTION SYSTEM (NNMS)

4701. Definitions—*Unless stated otherwise, the terms described below shall have the following meaning:*

[(d)] (a) The term *“active NNMS securities”* shall mean those NNMS eligible securities in which at least one NNMS Market Maker is currently active in NNMS.

[(i)] (b) The term *“Agency Quote”* shall mean the quotation that a registered NNMS Market Maker is permitted to display pursuant to the requirements of NASD Rule 4613(b).

(c) The term *“Attributable Quote/Order”* shall have the following meaning:

(1) For NNMS Market Makers and NNMS ECNs, a bid or offer Quote/Order that is designated for display (price and size) next to the participant's MMID in the Nasdaq Quotation Montage once such Quote/Order becomes the participant's best attributable bid or offer.

(2) For UTP Exchanges, the best bid and best offer quotation with price and size that is transmitted to Nasdaq by the UTP Exchange, which is displayed next to the UTP Exchange's MMID in the Nasdaq Quotation Montage.

[(h)] (d) The term *“Automated Confirmation Transaction”* service or *“ACT”* shall mean the automated

system owned and operated by The Nasdaq Stock Market, Inc. which compares trade information entered by ACT Participants and submits "locked-in" trades to clearing.

[(g)] (e) The term "automatic refresh size" shall mean the default size to which an NNMS Market Maker's quote will be refreshed pursuant to NASD Rule 4710(b)(2), if the market maker elects to utilize the Quote Refresh Functionality and does not designate to Nasdaq an alternative refresh size, which must be at least one normal unit of trading. The [maximum order] automatic refresh size default [size] amount shall be 1,000 shares.

(f) The term "Directed Order" shall mean an order that is entered into the system by an NNMS participant that is directed to a particular Quoting Market Participant at any price, through the Directed Order process described in Rule 4710(c). This term shall not include the "Preferred Order" described in subparagraph (aa) of this rule.

(g) The term "Displayed Quote/Order" shall mean both Attributable and Non-Attributable (as applicable) Quotes/Orders transmitted to Nasdaq by Quoting Market Participants.

(h) The term "Firm Quote Rule" shall mean SEC Rule 11Ac1-1.

(i) The term "Immediate or Cancel" shall mean, for limit orders so designated, that if after entry into the NNMS a marketable limit order (or unexecuted portion thereof) becomes non-marketable, the order (or unexecuted portion thereof) shall be canceled and returned to the entering participant.

(j) The term "Liability Order" shall mean an order that when delivered to a Quoting Market Participant imposes an obligation to respond to such order in a manner consistent with the Firm Quote Rule.

(k) The term "limit order" shall mean an order to buy or sell a stock at a specified price or better.

(l) The term "market order" shall mean an unpriced order to buy or sell a stock at the market's current best price.

(m) The term "marketable limit order" shall mean a limit order to buy that, at the time it is entered into the NNMS, is priced at the current inside offer or higher, or a limit order to sell that, at the time it is entered into the NNMS, is priced at the inside bid or lower.

(n) The term "mixed lot" shall mean an order that is for more than a normal unit of trading but not a multiple thereof.

(o) The term "Non-Attributable Quote/Order" shall mean a bid or offer Quote/Order that is entered by a Nasdaq Quoting Market Participant and is designated for display (price and size) on an anonymous basis in the Nasdaq Order Display Facility.

(p) The term "Non-Directed Order" shall mean an order that is entered into the system by an NNMS Participant and is not directed to any particular Quoting Market Participant, and shall also include Preferred Orders as described in subparagraph (aa) of this rule.

(q) The term "Non-Liability Order" shall mean an order that when delivered to a Quoting Market Participant imposes no obligation to respond to such order under the Firm Quote Rule.

[(a)] (r) The term "Nasdaq National Market Execution System," [or] "NNMS," or "system" shall mean the automated system owned and operated by The Nasdaq Stock Market, Inc. which enables NNMS Participants to execute transactions in active NNMS authorized securities; to have reports of the transactions automatically forwarded to the National Market Trade Reporting System, if required, for dissemination to the public and the industry, and to "lock in" these trades by sending both sides to the applicable clearing corporation(s) designated by the NNMS Participant(s) for clearance and settlement; and to provide NNMS Participants with sufficient monitoring and updating capability to participate in an automated execution environment.

[(c)] (s) The term "NNMS eligible securities" shall mean designated Nasdaq-listed [National Market (NNM)] equity securities.

(t) The term "NNMS ECN" shall mean a member of the Association that meets all of the requirements of NASD Rule 4623, and that participates in the NNMS with respect to one or more NNMS eligible securities.

(1) The term "NNMS Auto-Ex ECN" shall mean an NNMS ECN that participates in the automatic-execution functionality of the NNMS system, and accordingly executes Non-Directed Orders via automatic execution for the purchase or sale of an active NNMS security at the Nasdaq inside bid and/or offer price.

(2) The term "NNMS Order-Delivery ECN" shall mean an NNMS ECN that participates in the order-delivery functionality of the NNMS system, accepts delivery of Non-Directed Orders that are Liability Orders, and provides an automated execution of Non-Directed Orders (or an automated rejection of such orders if the price is no longer available) for the purchase or

sale of an active NNMS security at the Nasdaq inside bid and/or offer price.

[(e)] (u) The term "NNMS Market Maker" shall mean a member of the Association that is registered as a Nasdaq Market Maker and as a Market Maker for purposes of participation in NNMS with respect to one or more NNMS eligible securities, and is currently active in NNMS and obligated to execute orders through the automatic-execution functionality of the NNMS system for the purchase or sale of an active NNMS security at the Nasdaq inside bid and/or [ask] offer price.

[(b)] (v) The term "NNMS Participant" shall mean [either] an NNMS Market Maker, NNMS ECN, UTP Exchange, or NNMS Order Entry Firm registered as such with the Association for participation in NNMS.

[(f)] (w) The term "NNMS Order Entry Firm" shall mean a member of the Association who is registered as an Order Entry Firm for purposes of participation in NNMS which permits the firm to enter orders [of limited size] for execution against NNMS Market Makers.

(x) The term "Nasdaq Quotation Montage" shall mean the portion of the Nasdaq WorkStation presentation that displays for a particular stock two columns (one for bid, one for offer), under which is listed in price/time priority the MMIDs for each NNMS Market Maker, NNMS ECN, and UTP Exchange registered in the stock and the corresponding quote (price and size) next to the related MMID.

(y) The term "Nasdaq Quoting Market Participant" shall include only the following: (1) NNMS Market Makers; or (2) NNMS ECNs.

(z) The term "odd-lot order" shall mean an order that is for less than a normal unit of trading.

(aa) The term "Preferred Order" shall mean an order that is entered into the Non-Directed Order Process and is designated to be delivered to or executed against a particular Quoting Market Participant's Attributable Quote/Order when such Preferred Order is the next in line to be executed or delivered. Preferred Orders shall be executed subject to the conditions set out in Rule 4710(b).

(bb) The term "Quote/Order" shall mean a single quotation or shall mean an order or multiple orders at the same price submitted to Nasdaq by a Nasdaq Quoting Market Participant that is displayed in the form of a single quotation. Unless specifically referring to a UTP Exchange's Agency Quote/Order (as set out in Rule 4710(f)(2)(b)), when this term is used in connection

with a UTP Exchange, it shall mean the best bid and/or the best offer quotation transmitted to Nasdaq by the UTP Exchange.

(cc) The term "Quoting Market Participant" shall include any of the following: (1) NNMS Market Makers; (2) NNMS ECNs; and (3) UTP Exchange Specialists.

(dd) The term "Reserve Size" shall mean the system-provided functionality that permits a Nasdaq Quoting Market Participant to display in its Displayed Quote/Order part of the full size of a proprietary or agency order, with the remainder held in reserve on an undisplayed basis to be displayed in whole or in part after the displayed part is executed.

(ee) The term "Nasdaq Order Display Facility" shall mean the portion of the Nasdaq WorkStation presentation that displays, without attribution to a particular Quoting Market Participant's MMID, the three best price levels in Nasdaq on both the bid and offer side of the market and the aggregate size of Attributable and Non-Attributable Quotes/Orders at each price level.

(ff) The term "UTP Exchange" shall mean any registered national securities exchange that elects to participate in the NNMS and that has unlisted trading privileges in Nasdaq National Market securities pursuant to the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation and Dissemination Of Quotation and Transaction Information For Exchange-Listed Nasdaq/National Market System Securities Traded On Exchanges On An Unlisted Trading Privilege Basis ("Nasdaq UTP Plan").

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) execution of an NNMS Participant application agreement with the Association;

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

(3) registration as a market maker in The Nasdaq Stock Market pursuant to the Rule 4600 Series and compliance with all applicable rules and operating procedures of the Association and the Commission;

(4) maintenance of the physical security of the equipment located on the

premises of the NNMS Market Maker to prevent the improper use or access to Nasdaq systems, including unauthorized entry of information into NNMS; and

(5) acceptance and settlement of each NNMS trade that NNMS identifies as having been effected by such NNMS Market Maker, or if settlement is to be made through another clearing member, guarantee of the acceptance and settlement of such identified NNMS trade by the clearing member on the regularly scheduled settlement date.

(b) Pursuant to Rule 4611(f), participation as an NNMS Market Maker is required for any Nasdaq market maker registered to make a market in an NNMS security.

(c) Participation in NNMS as an NNMS Order Entry Firm requires current registration as such with the Association. Such registration shall be conditioned upon the NNMS Order Entry Firm's initial and continuing compliance with the following requirements:

(1) execution of an NNMS Participant application agreement with the Association;

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

(3) compliance with all applicable rules and operating procedures of the Association and the Securities and Exchange Commission;

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

(5) acceptance and settlement of each NNMS trade that NNMS identifies as having been effected by such NNMS Order Entry Firm or if settlement is to be made through another clearing member, guarantee of the acceptance and settlement of such identified NNMS trade by the clearing member on the regularly scheduled settlement date.

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

(1) the execution of an NNMS Participant application agreement with the Association;

(2) compliance with all requirements in NASD Rule 4623 and all other applicable rules and operating procedures of the Association and the Securities and Exchange Commission;

(3) membership in, or access arrangement with, a clearing agency

registered with the Commission which maintains facilities through which NNMS-compared trades may be settled;

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

(5) acceptance and settlement of each trade that is executed through the facilities of the NNMS, or if settlement is to be made through another clearing member, guarantee of the acceptance and settlement of such identified NNMS trade by the clearing member on the regularly scheduled settlement date.

[(d)](e) The registration required hereunder will apply solely to the qualification of an NNMS Participant to participate in NNMS. Such registration shall not be conditioned upon registration in any particular eligible or active NNMS securities.

[(e)](f) Each NNMS Participant shall be under a continuing obligation to inform the Association of noncompliance with any of the registration requirements set forth above.

(g) The Association and its subsidiaries shall not be liable for any losses, damages, or other claims arising out of the NNMS or its use. Any losses, damages, or other claims, related to a failure of the NNMS to deliver, display, transmit, execute, compare, submit for clearance and settlement, or otherwise process an order, Quote/Order, message, or other data entered into, or created by, the NNMS shall be absorbed by the member, or the member sponsoring the customer, that entered the order, Quote/Order, message, or other data into the NNMS.

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) An NNMS Participant may enter a Non-Directed Order into the NNMS in order to access the best bid/best offer as displayed in Nasdaq; provided however, that an NNMS Participant may enter a Preferred Order through the Non-Directed Order process to access a particular Quoting Market Participant without regard to the best bid/best offer as displayed in Nasdaq.

(B) A Non-Directed Order must be a market or marketable limit order, must be a round lot or a mixed lot, must indicate whether it is a buy, short sale, short-sale exempt, or long sale, and if entered by a Quoting Market Participant

may be designated as Immediate or Cancel.

(C) The system will not process a Non-Directed Order to sell short if the execution of such order would violate NASD Rule 3350.

(D) Non-Directed Orders will be processed as described in Rule 4710.

(E) The NNMS shall not accept Non-Directed Orders that are All-or-None, or have a minimum size of execution.

(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) All Non-Directed orders shall be designated as Immediate or Cancel. As such, 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.

(B) A Non-Directed Order that is a limit order may be entered prior to the market's open. Such orders will be held in queue, and if not marketable on the market's open, will be returned to the entering participant.

(b) Directed Orders—A participant may enter a Directed Order 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) an "All-or-None" order ("AON") that is at least one normal unit of trading (e.g. 100 shares) in excess of the Attributable Quote/Order of the Quoting Market Participant to which the order is directed; or

(B) a "Minimum Acceptable Quantity" order ("MAQ"), with a MAQ value of at least one normal unit of trading in excess of 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) A Directed Order may have a time in force of 1 to 99 minutes.

(3) Directed Orders shall be processed pursuant to Rule 4710(c).

(c) Entry of Agency and Principal Orders—NNMS Participants are

permitted to enter into the NNMS both agency and principal orders for delivery and execution processing.

(d) Order Size—Any round or mixed lot order up to 999,999 shares may be entered into the NNMS for normal execution processing. Odd-lot orders, and the odd-lot portion of a mixed lot, are subject to a separate execution process, as described in Rule 4710(e).

(e) Open Quotes—The NNMS will only deliver an order or an execution to a Quoting Market Participant if that participant has an open quote.

(f) Odd-Lot Orders—The system will accept odd-lot orders for processing through a separate facility. Odd-lot orders must be Non-Directed Orders, and may be market, marketable limit or limit orders. The system shall accept odd-lot orders at a rate no faster than one order per/second from any single participant. Odd-lot orders, and the odd-lot portion of a mixed lot order, shall be processed as described in Rule 4710(e).

4707. Entry and Display of Quotes/Orders

(a) Entry of Quotes/Orders—Nasdaq Quoting Market Participants may enter Quotes/Orders into the NNMS subject to the following requirements and conditions:

(1) Nasdaq Quoting Market Participants shall be permitted to transmit to the NNMS multiple Principal and Agency Quotes/Orders at a single as well as multiple price levels. Such Quote/Order shall indicate whether it is an "Attributable Quote/Order" or "Non-Attributable Quote/Order," and the amount of Reserve Size (if applicable).

(2) Upon entry of a Quote/Order into the system, the NNMS shall time-stamp it, which time-stamp shall determine the ranking of the Quote/Order for purposes of processing Non-Directed Orders as described in Rule 4710(b). For each subsequent size increase received for an existing quote at a given price, the system will maintain the original time-stamp for the original quantity of the quote and assign a separate time-stamp to that size increase.

(3) Consistent with Rule 4613, an NNMS Market Maker is obligated to maintain a two-sided Attributable Quote/Order (other than an Agency Quote) at all times, for at least one normal unit of trading.

(4) Nasdaq Quoting Market Participants may continue to transmit to the NNMS only their best bid and best offer Attributable Quotes/Orders. Notwithstanding NASD Rule 4613 and subparagraph (a)(1) of this rule, nothing in these rules shall require a Nasdaq

Quoting Market Participant to transmit to the NNMS multiple Quotes/Orders.

(b) Display of Quotes/Orders in Nasdaq—The NNMS will display a Nasdaq Quoting Market Participant's Quotes/Orders as follows:

(1) Attributable Quotes/Orders—The price and size of a Nasdaq Quoting Market Participant's best priced Attributable Quote/Order on both the bid and offer side of the market will be displayed in the Nasdaq Quotation Montage under the Nasdaq Quoting Market Participant's MMID, and also will be displayed in the Nasdaq Order Display Facility as part of the aggregate trading interest at a particular price when the price of such Attributable Quote/Order falls within the best three price levels in Nasdaq on either side of the market. Upon execution or cancellation of the Nasdaq Quoting Market Participant's best-priced Attributable Quote/Order on a particular side of the market, the NNMS will automatically display the participant's next best Attributable Quote/Order on that side of the market.

(2) Non-Attributable Quotes/Orders—The price and size of a Nasdaq Quoting Market Participant's Non-Attributable Quote/Order on both the bid and offer side of the market will be displayed in the Nasdaq Order Display Facility as part of the aggregate trading interest at a particular price when the price of such Non-Attributable Quote/Order falls within the best three price levels in Nasdaq on either side of the market. A Non-Attributable Order will not be displayed in the Nasdaq Quotation Montage under the Nasdaq Quoting Market Participant's MMID. Non-Attributable Quotes/Orders that are the best priced Non-Attributable bids or offers in the system will be displayed in the Nasdaq Quotation Montage under an anonymous MMID, which shall represent and reflect the aggregate size of all Non-Attributable Quotes/Orders in Nasdaq at that price level. Upon execution or cancellation of a Nasdaq Quoting Market Participant's Non-Attributable Quote/Order, the NNMS will automatically display a Non-Attributable Quote/Order in the Nasdaq Order Display Facility (consistent with the parameters described above) if it falls within the best three price levels in Nasdaq on either side of the market.

(c) Reserve Size—Reserve Size shall not be displayed in Nasdaq, but shall be electronically accessible as described in Rule 4710(b).

(d) Summary Scan—The "Summary Scan" functionality, which is a query-only non-dynamic functionality, displays without attribution to Quoting Market Participants' MMIDs the

aggregate size of Attributable and Non-Attributable Quotes/Orders for all levels (on both the bid and offer side of the market) below the three price levels displayed in the Nasdaq Order Display Facility.

(e) *NQDS Prime*—“*NQDS Prime*” is a separate data feed that Nasdaq will make available for a fee that is approved by the Securities and Exchange Commission. This separate data feed will display with attribution to Quoting Market Participants’ MMIDs all Attributable Quotes/Orders on both the bid and offer side of the market for the price levels that are disseminated in the Nasdaq Order Display Facility.

4710. Participant Obligations in NNMS

(a) Registration—Upon the effectiveness of registration as a NNMS Market Maker, NNMS ECN, 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) [Market Makers] *Non-Directed Orders*

(1) [An NNMS Market Maker] *General Provisions*—A Quoting Market Participant in an NNMS Security shall be subject to the following requirements for *Non-Directed Orders*:

(A) *Obligations* For each NNMS security in which it is registered [as an NNMS Market Maker, the market maker], a Quoting Market Participant must accept and execute individual *Non-Directed Orders* against its quotation including its Agency Quote (if applicable), in an amount equal to or smaller than the combination of the Displayed [quotation] Quote/Order and Reserve Size (if applicable) of such [quotation(s)] Quote/Order, when the Quoting Market Participant is at the best bid/best offer in Nasdaq. [For purposes of this rule, the term “reserved size” shall mean that a NNMS Market Maker or a customer thereof wishes to display publicly part of the full size of its order or interest with the remainder held in reserve on an undisplayed basis to be displayed in whole or in part as the displayed part is executed. To utilize the reserve size function, a minimum of 1,000 shares must initially be displayed in the market maker’s quote (including the Agency Quote), and the quotation must be refreshed to 1,000 shares consistent with subparagraph (b)(2)(A)

of this rule.] Quoting Market Participants shall participate in the NNMS as follows:

(i) NNMS Market Makers and NNMS Auto-Ex ECNs shall participate in the automatic-execution functionality of the NNMS, and shall accept the delivery of an execution up to the size of the participant’s Displayed Quote/Order and Reserve Size.

(ii) NNMS Order-Delivery ECNs shall participate in the order-delivery functionality of the NNMS, and shall accept the delivery of an order up to the size of the NNMS Order-Delivery ECN’s Displayed Quote/Order and Reserve Size. The NNMS Order-Delivery ECN shall be required to execute such order in a manner consistent with the Firm Quote Rule.

(iii) UTP Exchanges that choose to participate in the NNMS shall do so as described in subparagraph (f) of this rule and as otherwise described in the NNMS rules and the UTP Plan.

(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 in queue to receive an order is (based on the algorithm selected by the entering participant, as described in subparagraph (b)(B)(i)–(iii) of this rule), and shall deliver an execution to Quoting Market Participants 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; provided however, that the system always shall deliver an order (in lieu of an execution) to the Quoting Market Participant next in queue when the participant that entered the Non-Directed Order into the system is a UTP Exchange that does not provide automatic execution against its Quotes/Orders for Nasdaq Quoting Market Participants and NNMS Order Entry Firms. Non-Directed Orders entered into the NNMS system shall be delivered to or automatically executed against Quoting Market Participants’ Displayed [quotations] Quotes/Orders and Reserve Size, including Agency Quotes (if applicable), in strict price/time priority, as described in the algorithm contained in subparagraph (b)(B)(i) of this rule [For quotes at the same price, the system will yield priority to all displayed quotations over reserve size, so that the system will execute against Displayed quotations in time priority and then against reserve size in time priority]. Alternatively, an NNMS Market Participant can designate that its Non-Directed Orders be executed based on a price/time priority that considers ECN

quote-access fees, as described in subparagraphs (b)(B)(ii) of this rule, or executed based on price/size/time priority, as described in subparagraph (b)(B)(iii) of this rule.

(i) *Default Execution Algorithm—Price/Time*—The system will default to a strict price/time priority within Nasdaq, and will attempt to access interest in the system in the following priority and order:

(a) Displayed Quotes/Orders of NNMS Market Makers, NNMS ECNs, and Non-Attributable Agency Quotes/Orders of UTP Exchanges (as permitted by subparagraph (f) of this rule), in time priority between such participants’ Quotes/Orders.

(b) Reserve Size of Nasdaq Quoting Market Participants, in time priority between such participants’ Quotes/Orders; and

(c) Principal Quotes/Orders of UTP Exchanges, in time priority between such participants’ Quotes/Orders.

(ii) *Price/Time Priority Considering Quote-Access Fees*—If this options is chosen, the system will attempt to access interest in the system in the following priority and order:

(a) Displayed Quotes/Orders of NNMS Market Makers, NNMS ECNs that do not charge a separate quote-access fee to non-subscribers, and Non-Attributable Agency Quotes/Orders of UTP Exchanges (as permitted by subparagraph (f) of this rule), as well as Quotes/Orders from NNMS ECNs that charges a separate quote-access fee to non-subscribers where the ECN entering such Quote/Order indicates that the price improvement offered by the specific Quote/Order is equal to or exceeds the separate quote-access fee the ECN charges, in time priority between such participants’ Quotes/Orders;

(b) Displayed Quotes/Orders of NNMS ECNs that charge a separate quote-access fee to non-subscribers, in time priority between such participants’ Quotes/Orders;

(c) Reserve Size of NNMS Market Makers and NNMS ECNs that do not charge a separate quote-access fee to non-subscribers, as well as Reserve Size of Quotes/Orders from NNMS ECNs that charges a separate quote-access fee to non-subscribers where the ECN entering such Quote/Order has indicated that the price improvement offered by the specific Quote/Order is equal to or exceeds the separate quote-access fee the ECN charges, in time priority between such participants’ Quotes/Orders;

(d) Reserve Size of NNMS ECNs that charge a separate quote-access fee to non-subscribers, in time priority

between such participants' Quotes/Orders; and

(e) Principal Quotes/Orders of UTP Exchanges, in time priority between such participants' Quotes/Orders.

(iii) Price/Size Priority—If this option is chosen, Non-Directed Orders shall be execute in price/size/time priority against:

(a) Displayed Quotes/Orders of NNMS Market Makers, NNMS ECNs, and Non-Attributable Agency Quotes/Orders of UTP Exchanges (as permitted by subparagraph (f) of this rule), in price/size/time priority between such participants' Quotes/Orders;

(b) the Reserve Size of Nasdaq Quoting Market Participants, in price/size/time priority between such participants' Quotes/Orders, which size priority shall be based on the size of the Displayed Quote/Order, and not on the amount held in Reserve Size; and

(c) Principal Quotes/Orders of UTP Exchanges, in price/size/time priority between such participants' Quotes/Orders.

(iv) Exceptions—The following exceptions shall apply to the above execution parameters:

(a) If a Nasdaq Quoting Market Participant enters a Non-Directed Order into the system, before sending such Non-Directed Order to the next Quoting Market Participants in queue, the NNMS will first attempt to match off the order against the Nasdaq Quoting Market Participant's own Quote/Order if the participant is at the best bid/best offer in Nasdaq.

(b) If an NNMS Market Participant enters a Preferred Order, the order shall be executed against (or delivered in an amount equal to) both the Displayed Quote/Order and Reserve Size at the displayed price of the Quoting Market Participant to which the order is being directed, without regard to whether the Quoting Market Participant is at the best bid/best offer, with any unexecuted portion being returned to the entering NNMS Market Participant.

(c) Decrementation Procedures—The size of a [displayed quotation] 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[n NNMS] Non-Directed [o]Order or Preferred Order in an amount equal to [or greater than one normal unit of trading] the system-delivered order or execution; provided, however, that [the execution of] if an NNMS order that is a mixed lot, the system will only deliver a Liability Order or an execution for the number of round lots contained in the

mixed lot order, and will only decrement [a displayed quotation's] the size of a Displayed Quote/Order by the number of shares represented by the number of round lots contained in the mixed lot order. The odd-lot portion of the mixed lot will be executed at the same price against the NNMS Market Maker next in the odd lot rotation, as described in subparagraph (e) of this rule.

(i) If an NNMS Auto-Ex ECN has its bid or offer Attributable Quote/Order and Reserve Size decremented to zero without transmission of another Attributable Quote/Order to Nasdaq, the system will zero out the side of the quote that is exhausted. If both the bid and offer are decremented to zero without transmission of a revised Attributable Quote/Order, the ECN will be placed into an excused withdrawal state until the ECN transmits to Nasdaq a revised Attributable Quote/Order.

(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 in queue. The system then will zero out the ECN's Quote/Orders at that price level on that side of the market, 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) If an NNMS ECN's Quote/Order has been zeroed out or if the ECN has been placed into excused withdrawal as described in subparagraphs (b)(1)(C)(i) and (ii) of this rule, the system will continue to access the ECN's Non-Attributable Quotes/Orders that are in the NNMS, as described in Rule 4707 and subparagraph (b) of this rule.

(iv) If an NNMS ECN regularly fails to meet a 5-second response time (as measured by the ECN's Service Delivery Platform) over a period of orders, such that the failure endangers the maintenance of a fair and orderly market, Nasdaq will place that ECN's quote in a closed-quote state. Nasdaq will lift the closed-quote state when the NNMS ECN certifies that it can meet the 5-second response time requirement

with regularity sufficient to maintain a fair and orderly market.

(D) Interval Delay—After the NNMS system has executed all Displayed Quotes/Orders and Reserve Size interest at a price level [an order against a market maker's displayed quote and reserve size (if applicable), that market maker shall not be required to execute another order at its bid or offer in the same security until a predetermined time period has elapsed from the time the order was executed, as measured by the time of execution in the Nasdaq system. This period of time shall initially be established as 5 seconds, but may be modified upon Commission approval and appropriate notification to NNMS participants.], the following will occur:

(i) If the NNMS system cannot execute in full all shares of a Non-Directed Order against the Displayed Quotes/Orders and Reserve Size interest at the initial price level and at price two minimum trading increments away, the system will pause for 5 seconds before accessing the interest at the next price level in the system; provided, however, that once the Non-Directed Order can be filled in full within two price levels, there will be no interval delay between price levels and the system will execute the remainder of order in full; or

(ii) If the Non-Directed Orders is specially designated by the entering market participant as a "sweep order," the system will execute against all Displayed Quotes/Orders and Reserve Size at the initial price level and the two price levels being displayed in the Nasdaq Order Display Facility without pausing between the displayed price levels. Thereafter, the system will pause 5 seconds before moving to the next price level, until the Non-Directed Order is executed in full.

(iii) The interval delay described in this subparagraph may be modified upon Commission approval and appropriate notification to NNMS Participants.

(E) All entries in NNMS shall be made in accordance with the requirements set forth in the NNMS User Guide, as published from time to time by Nasdaq.

(2) Refresh Functionality

(A) Reserve Size Refresh—Once a Nasdaq Quoting Market Participant's [an NNMS Market Maker's displayed quotation] Displayed Quote/Order size on either side of the market in the security has been decremented to zero due to NNMS [executions] processing Nasdaq will refresh the [market maker's] displayed size out of Reserve Size to a size-level designated by the Nasdaq Quoting Market Participant [NNMS

Market Maker], or in the absence of such size-level designation, to the automatic refresh size. [If the market maker is using the reserve size function for its proprietary quote or Agency Quote the NNMS Market Maker must refresh to a minimum of 1,000 shares, consistent with subparagraph (b)(1)(A) of this rule]. *To utilize the Reserve Size functionality, a minimum of 1,000 shares must initially be displayed in the Nasdaq Quoting Market Participant's Displayed Quote/Order, and the Displayed Quote/Order must be refreshed to at least 1,000 shares. This functionality will not be available for use by UTP Exchanges.*

(B) [Auto q]Quote Refresh ("QR")—Once an NNMS Market Maker's Displayed Quote/Order [quotation] size and Reserve Size on either side of the market in the security has been decremented to zero due to NNMS executions, the NNMS Market Maker may elect to have The Nasdaq Stock Market refresh the market maker's quotation as follows:

(i) Nasdaq will refresh the market maker's quotation price on the bid or offer side of the market, whichever is decremented to zero, by a[n] price interval designated by the NNMS Market Maker; and

(ii) Nasdaq will refresh the market maker's displayed size to a level designated by the NNMS Market Maker, or in the absence of such size level designation, to the automatic refresh size. [A Market Maker's Agency Quotation shall not be subject to the functionality described in this subparagraph.]

(iii) *This functionality shall produce an Attributable Quote/Order. In addition, if an NNMS Market Maker is utilizing the QR functionality but has an Attributable Quote/Order in the system that is priced at or better than the quote that would be created by the QR, the NNMS will display the Attributable Quote/Order, not the QR-produced quote.*

(iv) *An NNMS Market Maker's Agency Quote shall not be subject to the functionality described in this subparagraph, nor shall this functionality be available to Quoting Market Participants other than NNMS Market Makers.*

(3) *Entry of Locking/Crossing Quotes/Orders* [Except as otherwise provided in subparagraph (b)(10) of this rule, at any time a locked or crossed market, as defined in Rule 4613(e), exists for an NNMS security, a market maker with a quotation for that security (including an Agency Quote) that is causing the locked or crossed market may have orders representing shares equal to the size of the bid or offer that is locked or

crossed executed by the NNMS system against the market maker's quote (including an Agency Quote) at the quoted price if that price is the best price. During locked or crossed markets, the NNMS system will execute orders against those market makers that are locked or crossed in predetermined time intervals. This period of time initially shall be established as five (5) seconds, but may be modified upon approval by the Commission and appropriate notification to NNMS participants.] *The system shall process locking/crossing Quotes/Orders as follows:*

(A) *Locked/Crossed Quotes/Orders During Market Hours—If during market hours, a Quoting Market Participant enters into the NNMS a Quote/Order that will lock/cross the market (as defined in NASD Rule 4613(e)), the system will not display the Quote/Order as a quote in Nasdaq; instead the system will treat the Quote/Order as a marketable limit order and enter it into the system as a Non-Directed Order for processing (consistent with subparagraph (b) of this rule) as follows:*

(i) *For locked-market situations, the order will be routed to the Quoting Market Participant next in queue who would be locked, and the order will be executed (or delivered for execution) at the lock price;*

(ii) *For crossed-market situations, the order will be entered into the system and routed to the next Quoting Market Participants in queue who would be crossed, and the order will be executed (or delivered for execution) at the price of the Displayed Quote/Order that would have been crossed.*

Once the lock/cross is cleared, if the participant's order is not completely filled, the system will reformat the order and display it in Nasdaq (consistent with the parameters of the Quote/Order) as a Quote/Order on behalf of the entering Quoting Market Participant.

(B) *Locked/Crossed Quotes/Orders at the Open—If the market is locked or crossed at 9:30 a.m., Eastern Time, the NNMS will clear the locked and/or crossed Quotes/Order by executing (or delivering for execution) the oldest bid/offer against the oldest offer(bid) against which it is marketable at the price of the oldest Quote/Order. Nasdaq then will begin processing Non-Directed Orders as described in subparagraph (b) of this rule.*

[(4) For each NNM security in which a market maker is registered, the market maker may enter orders into the NNMS for its proprietary account as well as on an agency or riskless principal basis.]

[(5)] (4) An NNMS Market Maker may terminate its obligation by keyboard withdrawal (or its equivalent) from

NNMS at any time. However, the market maker has the specific obligation to monitor its status in NNMS to assure that a withdrawal has in fact occurred. Any transaction occurring prior to the effectiveness of the withdrawal shall remain the responsibility of the market maker.

[(6)] (5) [An NNMS Market Maker will be suspended from NNMS if its bid or offer has been decremented to zero due to NNMS executions and will be permitted a standard grace period, the duration of which will be established and published by the Association, within which to take action to restore a two-sided quotation in the security for at least one normal unit of trading. An NNMS Market Maker that fails to reenter a two-sided quotation within the allotted time will be deemed to have withdrawn as a market maker ("Timed Out of the Box"). Except as provided below in this subparagraph and in subparagraph (b)(7) of this rule, an NNMS Market Maker that withdraws in an NNM security may not re-register as a market maker in that security for twenty (20) business days.] *If an NNMS Market Maker's Attributable Quote/Order is reduced to zero on one side of the market due to NNMS executions, the NNMS will close the Market Maker's quote in the NNMS with respect to both sides of its market, and the NNMS Market Maker will be permitted a grace period of three minutes within which to take action to restore its Attributable Quote/Order, if the market maker has not authorized use of the QR functionality or does not otherwise have an Attributable Quote/Order on both sides of the market in the system. An NNMS Market Maker that fails to transmit an Attributable Quote/Order in a security within the allotted time will have its quotation restored by the system at the lowest bid price and the highest offer price in that security. Except as provided in subparagraph (b)(6) of this rule, an NNMS Market Maker that withdraws from a security may not re-register in the system as a market maker in that security for twenty (20) business days. The requirements of this subparagraph shall not apply to a market maker's Agency Quote.*

[(A) Notwithstanding the above, a market maker can be reinstated if:

(i) the market maker makes a request for reinstatement to Nasdaq Market Operations as soon as practicable under the circumstances, but within at least one hour of having been Timed Out of the Box, and immediately thereafter provides written notification of the reinstatement request;

(ii) it was a Primary Market Maker at the time it was Timed Out of the Box;

(iii) the market maker's firm would not exceed the following reinstatement limitations:

a. for firms that simultaneously made markets in less than 250 stocks during the previous calendar year, the firm can receive no more than four (4) reinstatements per year;

b. for firms that simultaneously made markets in 250 or more but less than 500 stocks during the previous calendar year, the firm can receive no more than six (6) reinstatements per year;

c. for firms that simultaneously made markets in 500 or more stocks during the previous calendar year, the firm can receive no more than twelve (12) reinstatements per year; and

(iv) the designated Nasdaq officer makes a determination that the withdrawal was not an attempt by the market maker to avoid its obligation to make a continuous two-sided market. In making this determination, the designated Nasdaq officer will consider, among other things:

a. whether the market conditions in the issue included unusual volatility or other unusual activity, and/or the market conditions in other issues in which the market maker made a market at the time the firm was Timed Out of the Box;

b. the frequency with which the firm has been Timed Out of the Box in the past;

c. procedures the firm has adopted to avoid being inadvertently Timed Out of the Box; and

d. the length of time before the market maker sought reinstatement.

(B) If a market maker has exhausted the reinstatement limitations in subparagraph (b)(6)(A)(iii) above, the designated Nasdaq officer may grant a reinstatement request if he or she finds that such reinstatement is necessary for the protection of investors or the maintenance of fair and orderly markets and determines that the withdrawal was not an attempt by the market maker to avoid its obligation to make a continuous two-sided market in instances where:

(i) a member firm experiences a documented problem or failure impacting the operation or utilization of any automated system operated by or on behalf of the firm (chronic system failures within the control of the member will not constitute a problem or failure impacting a firm's automated system) or involving an automated system operated by Nasdaq;

(ii) the market maker is a manager or co-manager of a secondary offering from the time the secondary offering is announced until ten days after the offering is complete; or

(iii) absent the reinstatement, the number of market makers in a particular issue is equal to two (2) or less or has otherwise declined by 50% or more from the number that existed at the end of the prior calendar quarter, except that if a market maker has a regular pattern of being frequently Timed Out of the Box, it may not be reinstated notwithstanding the number of market makers in the issue.]

[(7)] (6) Notwithstanding the provisions of subparagraph [(6)] (5) above:

(A) an NNMS Market Maker that obtains an excused withdrawal pursuant to Rule 4619 prior to withdrawing from NNMS may reenter NNMS according to the conditions of its withdrawal; and

(B) a NNMS Market Maker that fails to maintain a clearing arrangement with a registered clearing agency or with a member of such an agency, and is thereby withdrawn from participation in ACT and NNMS for NNMS securities, may reenter NNMS after a clearing arrangement has been reestablished and the market maker has complied with ACT participant requirements. Provided however, that if the Association finds that the ACT market maker's failure to maintain a clearing arrangement is voluntary, the withdrawal of quotations will be considered voluntary and unexcused.

[(8)] (7) The Market Operations Review Committee shall have jurisdiction over proceedings brought by market makers seeking review of their removal from NNMS pursuant to subparagraph[s] (b)(5)[(6) or (b)(7)] of this rule.

[(9)] (8) In the event that a malfunction in the [NNMS Market Maker's] *Quoting Market Participant's* equipment occurs, rendering [on-line] communications with NNMS inoperable, the [NNMS Market Maker] *Quoting Market Participant* is obligated to immediately contact Nasdaq Market Operations by telephone to request withdrawal from NNMS *and a closed-quote status, and if the Quoting Market Participant is an NNMS Market Maker* an excused withdrawal from Nasdaq[. Such request must be made] pursuant to Rule 4619. If withdrawal is granted, Nasdaq Market Operations personnel will enter the withdrawal notification into NNMS from a supervisory terminal *and shall close the quote*. Such manual intervention, however, will take a certain period of time for completion and, *unless otherwise permitted by the Association pursuant to its authority under Rule 11890*, the [NNMS Market Maker] *Quoting Market Participant* will continue to be obligated for any transaction executed prior to the

effectiveness of [his] *the* withdrawal *and closed-quote status*.

[(10)] In the event that there are no NNMS Market Makers at the best bid (offer) disseminated by Nasdaq, market orders to sell (buy) entered into NNMS will be held in queue until executable, or until 90 seconds has elapsed, after which such orders will be rejected and returned to their respective order entry firms.]

(c) *Directed Order Processing*—A participant may enter a *Directed Order* into the NNMS to access a specific *Quote/Order* in the Nasdaq Quotation Montage and to begin the negotiation process with a particular *Quoting Market Participant*. The system will deliver an order (not an execution) to the *Quoting Market Participant* designated as the recipient of the order. Upon delivery, the *Quoting Market Participant* shall owe no liability under the *Firm Quote Rule* to that order, 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* (as described in Rule 4706(b)). Additionally, upon delivery, the system will not decrement the receiving *Quoting Market Participant's Quote/Order*. This provision shall not apply to *Preferred Orders*.

[(c)] (d) NNMS Order Entry Firms
All entries in NNMS shall be made in accordance with the procedures and requirements set forth in the NNMS User Guide. Orders may be entered in NNMS by the NNMS Order Entry Firm through either its Nasdaq terminal or computer interface. The system will transmit to the firm on the terminal screen and printer, if requested, or through the computer interface, as applicable, an execution report generated immediately following the execution.

[(d)] Order Entry Parameters
(1) NNMS will only accept market and marketable limit orders for execution and will not accept market or marketable limit orders designated as All-or-None ("AON") orders; provided, however, that NNMS will not accept any limit orders, marketable or unmarketable, prior to 9:30 a.m., Eastern Time. For purposes of this subparagraph, an AON order is an order for an amount of securities equal to the size of the order and no less.

(2) Additionally, the NNMS will only accept orders that are unpreferred, thereby resulting in execution in rotation against NNMS Market Makers, and will not accept preferred orders.

(3) NNMS will not accept orders that exceed 9,900 shares, and no participant in the NNMS system shall enter an

order into the system that exceeds 9,900.]

[(e) Electronic Communication Networks

An Electronic Communications Networks, as defined in SEC Rule 11Ac1-1(a)(8), may participate in the NNMS System if it complies with NASD Rule 4623 and executes with the Association a Nasdaq Workstation Subscriber Agreement, as amended, for ECNs.]

(e) Odd-Lot Processing

(1) Participation in Odd-Lot Process—All NNMS Market Makers may participate in the Odd-Lot Process for each security in which the market maker is registered.

(2) Execution Process

(A) Odd-lot orders will be executed against an NNMS Market Maker only if it has an odd-lot exposure limit in an amount that would fill the odd-lot order. A NNMS Market Maker may, on a security-by-security basis, set an odd-lot exposure limit from 0 to 999,999 shares.

(B) An odd-lot order shall be executed automatically against the next available NNMS Market Maker when the odd-lot order becomes executable (i.e., when the best price in Nasdaq moves to the price of the odd-lot limit order). Such odd-lot orders will execute at the best price available in the market, in rotation against NNMS Market Makers who have an exposure limit that would fill the odd-lot order.

(C) For odd lots that are part of a mixed lot, once the round-lot portion is executed, the odd-lot portion will be executed at the round-lot price against the next NNMS Market Maker in rotation (as described in subparagraph (e)(2)(b) of this rule) even if the round-lot price is no longer the best price in Nasdaq.

(D) Odd-lot executions will decrement the odd-lot exposure limit of an NNMS Market Maker but will not decrement the size of NNMS Market Maker's Displayed Quote/Order.

(E) After the NNMS system has executed an odd lot against an NNMS Market Maker, the system will not deliver another odd-lot order against the same market maker until a predetermined time period has elapsed from the time the last execution was delivered, as measured by the time of execution in the Nasdaq system. This period of time shall initially be established as 5 seconds, but may be increased upon Commission approval and appropriate notification to NNMS Participants or may be decreased to an amount less than five seconds by the NNMS Market Maker.

(f) UTP Exchanges

Participation in the NNMS by UTP Exchanges is voluntary. If a UTP Exchange elects to participate in the system, Nasdaq shall endeavor to provide fair and equivalent access to the Nasdaq market for UTP Exchanges, as a UTP Exchange provides to its market for Nasdaq Quoting Market Participants and NNMS Order Entry Firms. The following provisions shall apply to UTP Exchanges that choose to participate in the NNMS:

(1) Order Entry—UTP Exchanges that elect to participate in the system shall be permitted to enter Directed and Non-Directed Orders into the system subject to the conditions and requirements of Rules 4706. Directed and Non-Directed Orders entered by UTP Exchanges shall be processed (unless otherwise specified) as described in subparagraphs (b) and (c) of this rule.

(2) Display of UTP Exchange Quotes/Orders in Nasdaq

(A) UTP Exchange Principal Orders/Quotes—UTP Exchanges that elect to participate in the system shall be permitted to transmit to the NNMS a single bid Quote/Order and a single offer Quote/Order. Upon transmission of the Quote/Order to Nasdaq, the system shall time stamp the Quote/Order, which time stamp shall determine the ranking of the Quote/Order for purposes of processing Non-Directed Orders. The NNMS shall display the best bid and best offer Quote/Order transmitted to Nasdaq by a UTP Exchange in the Nasdaq Quotation Montage under the MMID for the UTP Exchange, and shall also display such Quote/Order in the Nasdaq Order Display Facility as part of the aggregate trading interest when the UTP Exchange's best bid/best offer Quote/Order falls within the best three price levels in Nasdaq on either side of the market.

(B) UTP Exchange Agency Quotes/Orders

(i) A UTP Exchange that elects to participate in the system may transmit to the NNMS Quotes/Orders at a single as well as multiple price levels that meet the following requirements: are not for the benefit of a broker and/or dealer that is with respect to the UTP Exchange a registered or designated market maker, dealer or specialist in the security at issue; and are designated as Non-Attributable Quotes/Orders ("UTP Agency Order/Quote").

(ii) Upon transmission of a UTP Agency Quote/Order to Nasdaq, the system shall time stamp the order, which time stamp shall determine the ranking of these Quote/Order for purposes of processing Non-Directed

Orders, as described in subparagraph (b) of this rule. A UTP Agency Quote/Order shall not be displayed in the Nasdaq Quotation Montage under the MMID for the UTP Exchange. Rather, UTP Agency Quotes/Orders shall be reflected in the Nasdaq Order Display Facility and Nasdaq Quotation Montage in the same manner in which Non-Attributable Quotes/Orders from Nasdaq Quoting Market Participants are reflected in Nasdaq, as described in Rule 4707(b)(2).

(3) Non-Directed Order Processing

(a) UTP Exchanges that elect to participate in the system and that agree to provide automatic execution against their Quotes/Orders for Nasdaq Quoting Market Participants and NNMS Order Entry Firms, shall accept an execution of an order up to the size of the UTP Exchange's displayed Quote/Order, and shall have Non-Directed Orders they enter into the system processed as described in subparagraph (b) of this rule.

(b) UTP Exchanges that elect to participate in the system but that do not provide automatic execution against their Quotes/Orders for Nasdaq Quoting Market Participants and NNMS Order Entry Firms, shall accept the delivery of an order up to the size of the UTP Exchange's Displayed Quote/Order, and shall have Non-Directed Orders they enter into the system processed as described in subparagraph (b) of this rule. If such a UTP Exchange declines or partially fills a Non-Directed Order without immediately transmitting to Nasdaq a revised Quote/Order that is at a price inferior to the previous price, or if such a UTP Exchange fails to respond in any manner within 30 seconds of order delivery, the NNMS will send the order (or remaining portion thereof) back into the system for delivery to the next Quoting Market Participant in queue. The system will then move the side of such UTP Exchange's Quote/Order to which the declined or partially-filled order was delivered, to the lowest bid or highest offer price in Nasdaq, at a size of 100 shares.

(4) Directed Order Processing—UTP Exchanges that elect to participate in the system shall participate in the Directed Order processing as described in subparagraph (c) of this rule.

(5) Decrementation—UTP Exchanges shall be subject to the decrementation procedures described in subparagraph (b) of this rule.

(6) Scope of Rules "Nothing in these rules shall apply to UTP Exchanges that elect not to participate in the system."

4711-4714—No Change**4718. Termination of System Service**

The Association or its subsidiaries may, upon notice, terminate system service to a participant in the event that a participant fails to abide by any of the rules or operating procedures of the System or any other relevant rule or requirement, or fails to pay promptly for services rendered.

* * * * *

4750. SMALLCAP SMALL ORDER EXECUTION SYSTEM (SOES)**4751-4757—Deleted**

B. Proposed Rule Language for File No. NASD-99-53 containing Alternative B Proposed additions are in italics and proposed deletions are placed in [brackets].

4720. SelectNet Service—Deleted

* * * * *

4611. Registration as a Nasdaq Market Maker

(a)–(e) No Change.

(f) Unless otherwise specified by the Association, each Nasdaq market maker that is registered as a market maker in a Nasdaq[National Market security]-listed security shall also at all times be registered as a market maker in the Nasdaq National Market Execution System (NNMS) with respect to that security and be subject to the NNMS Rules as set forth in the Rule 4700 Series. [Participation in the Small Order Execution System (SOES) shall be voluntary for any Nasdaq market maker registered to make a market in a Nasdaq SmallCap security.]

* * * * *

(g) No Change.

4613. Character of Quotations**(a) Two-Sided Quotations**

(1) For each security in which a member is registered as a market maker, the member shall be willing to buy and sell such security for its own account on a continuous basis and shall enter and maintain a two-sided quotation[s] (*“Principal Quote”*), which is attributed to the market maker by a special maker participant identifier (*“MMID”*) and is displayed in the Nasdaq Quotation Montage [in The Nasdaq Stock Market] at all times, subject to the procedures for excused withdrawal set forth in Rule 4619.

(A) A registered market maker in a Nasdaq-listed security [listed on The Nasdaq Stock Market] must display a quotation size for at least one normal unit of trading (or a larger multiple thereof) when it is not displaying a limit

order in compliance with SEC Rule 11Ac1-4, provided, however, that a registered market maker may augment its displayed quotation size to display limit orders priced at the market maker's quotation. *Unless otherwise designated, a “normal unit of trading” shall be 100 shares.*

(b) Agency Quote—Amendments Pending Pursuant to SR-NASD-99-09.

(c)–(e) No Change.

IM-4613. Autoquote Policy—No Change**4618. Clearance and Settlement**

(a)–(b) No Changes.

(c) All transactions through the facilities of the Nasdaq National Market Execution System[, SOES, and SelectNet services] shall be cleared and settled through a registered clearing agency using a continuous net settlement system.

* * * * *

4619. Withdrawal of Quotations and Passive Market Making

(a)–(b) No Change.

(c) Excused withdrawal status may be granted to a market maker that fails to maintain a clearing arrangement with a registered clearing agency or with a member of such an agency and is withdrawn from participation in the Automated Confirmation Transaction service, thereby terminating its registration as a market maker in Nasdaq issues. Provided however, that if the Association finds that the market maker's failure to maintain a clearing arrangement is voluntary, the withdrawal of quotations will be considered voluntary and unexcused pursuant to Rule 4620[, the Rules for the Small Order Execution System, as set forth in the Rule 4750 Series,] and the Rule 4700 Series governing the Nasdaq[s] National Market Execution System.

(d) No Change.

* * * * *

4620. Voluntary Termination of Registration

(a) A market maker may voluntarily terminate its registration in a security by withdrawing its *Principal* [quotations] *Quote* from The Nasdaq Stock Market. A market maker that voluntarily terminates its registration in a security may not re-register as a market maker in that security for twenty (20) business days. Withdrawal from participation as a market maker in a Nasdaq [National Market]-listed security in the Nasdaq National Market Execution System shall constitute termination of registration as a market maker in that security for purposes of this Rule; provided,

however, that a market maker that fails to maintain a clearing arrangement with a registered clearing agency or with a member of such an agency and is withdrawn from participation in the Automated Confirmation Transaction System and thereby terminates its registration as a market maker in Nasdaq-listed [National Market and SmallCap] issues may register as a market maker at any time after a clearing arrangement has been reestablished and the market maker has complied with ACT participant requirements contained in Rule 6100.

* * * * *

4632. Transaction Reporting

(a)–(d) No Change.

(e) Transactions Not Required To Be Reported

The following types of transactions shall not be reported:

(1) Transactions executed through the Computer Assisted Execution System (CAES), *or the facilities of the Nasdaq National Market Execution System (“NNMS”)*, or the SelectNet service];

(2)–(6) No Change.

(f) No Change.

4642. Transaction Reporting

(a)–(d) No Change.

(e) Transactions Not Required To Be Reported

The following types of transactions shall not be reported:

(1) Transactions executed through the Computer Assisted Execution System (CAES); the Small Order Execution System (SOES) or the SelectNet service] *or facilities of the Nasdaq National Market Execution System (“NNMS”).*

(2)–(5) No Change.

(f) No Change.

* * * * *

4700. NASDAQ NATIONAL MARKET EXECUTION SYSTEM (NNMS)

4701. Definitions—*Unless stated otherwise, the terms described below shall have the following meaning:*

[(d)] (a) The term “active NNMS securities” shall mean those NNMS eligible securities in which at least one NNMS Market Maker is currently active in NNMS.

[(i)] (b) The term “Agency Quote” shall mean the quotation that a registered NNMS Market Maker is permitted to display pursuant to the requirements of NASD Rule 4613(b).

(c) The term “Attributable Quote/Order” shall have the following meaning:

(1) For NNMS Market Makers and NNMS ECNs, a bid or offer Quote/Order that is designated for display (price and

size) next to the participant's MMID in the Nasdaq Quotation Montage once such Quote/Order becomes the participant's best attributable bid or offer.

(2) For UTP Exchanges, the best bid and best offer quotation with price and size that is transmitted to Nasdaq by the UTP Exchange, which is displayed next to the UTP Exchange's MMID in the Nasdaq Quotation Montage.

[(h)] (d) The term "Automated Confirmation Transaction" service or "ACT" shall mean the automated system owned and operated by The Nasdaq Stock Market, Inc. which compares trade information entered by ACT Participants and submits "locked-in" trades to clearing.

[(g)] (e) The term "automatic refresh size" shall mean the default size to which an NNMS Market Maker's quote will be refreshed pursuant to NASD Rule 4710(b)(2), if the market maker elects to utilize the Quote Refresh Functionality and does not designate to Nasdaq an alternative refresh size, which must be at least one normal unit of trading. The [maximum order] automatic refresh size default [size] amount shall be 1,000 shares.

(f) The term "Directed Order" shall mean an order that is entered into the system by an NNMS participant that is directed to a particular Quoting Market Participant at any price, through the Directed Order process described in Rule 4710(c). This term shall not include the "Preferred Order" described in subparagraph (aa) of this rule.

(g) The term "Displayed Quote/Order" shall mean both Attributable and Non-Attributable (as applicable) Quotes/Orders transmitted to Nasdaq by Quoting Market Participants.

(h) The term "Firm Quote Rule" shall mean SEC Rule 11Ac1-1.

(i) The term "Immediate or Cancel" shall mean, for limit orders so designated, that if after entry into the NNMS a marketable limit order (or unexecuted portion thereof) becomes non-marketable, the order (or unexecuted portion thereof) shall be canceled and returned to the entering participant.

(j) The term "Liability Order" shall mean an order that when delivered to a Quoting Market Participant imposes an obligation to respond to such order in a manner consistent with the Firm Quote Rule.

(k) The term "limit order" shall mean an order to buy or sell a stock at a specified price or better.

(l) The term "market order" shall mean an unpriced order to buy or sell

a stock at the market's current best price.

(m) The term "marketable limit order" shall mean a limit order to buy that, at the time it is entered into the NNMS, is priced at the current inside offer or higher, or a limit order to sell that, at the time it is entered into the NNMS, is priced at the inside bid or lower.

(n) The term "mixed lot" shall mean an order that is for more than a normal unit of trading but not a multiple thereof.

(o) The term "Non-Attributable Quote/Order" shall mean a bid or offer Quote/Order that is entered by a Nasdaq Quoting Market Participant and is designated for display (price and size) on an anonymous basis in the Nasdaq Order Display Facility.

(p) The term "Non-Directed Order" shall mean an order that is entered into the system by an NNMS Participant and is not directed to any particular Quoting Market Participant, and shall also include Preferred Orders as described in subparagraph (aa) of this rule.

(q) The term "Non-Liability Order" shall mean an order that when delivered to a Quoting Market Participant imposes no obligation to respond to such order under the Firm Quote Rule.

[(a)] (r) The term "Nasdaq National Market Execution System," [or] "NNMS," or "system" shall mean the automated system owned and operated by The Nasdaq Stock Market, Inc. which enables NNMS Participants to execute transactions in active NNMS authorized securities; to have reports of the transactions automatically forwarded to the National Market Trade Reporting System, if required, for dissemination to the public and the industry, and to "lock in" these trades by sending both sides to the applicable clearing corporation(s) designated by the NNMS Participant(s) for clearance and settlement; and to provide NNMS Participants with sufficient monitoring and updating capability to participate in an automated execution environment.

[(c)] (s) The term "NNMS eligible securities" shall mean designated Nasdaq-listed [National Market (NNM)] equity securities.

(t) The term "NNMS ECN" shall mean a member of the Association that meets all of the requirements of NASD Rule 4623, and that participates in the NNMS with respect to one or more NNMS eligible securities.

(1) The term "NNMS Auto-Ex ECN" shall mean an NNMS ECN that participates in the automatic-execution functionality of the NNMS system, and accordingly executes Non-Directed Orders via automatic execution for the

purchase or sale of an active NNMS security at the Nasdaq inside bid and/or offer price.

(2) The term "NNMS Order-Delivery ECN" shall mean an NNMS ECN that participates in the order-delivery functionality of the NNMS system, accepts delivery of Non-Directed Orders that are Liability Orders, and provides an automated execution of Non-Directed Orders (or an automated rejection of such orders if the price is no longer available) for the purchase or sale of an active NNMS security at the Nasdaq inside bid and/or offer price.

[(e)] (u) The term "NNMS Market Maker" shall mean a member of the Association that is registered as a Nasdaq Market Maker and as a Market Maker for purposes of participation in NNMS with respect to one or more NNMS eligible securities, and is currently active in NNMS and obligated to execute orders through the automatic-execution functionality of the NNMS system for the purchase or sale of an active NNMS security at the Nasdaq inside bid and/or [ask] offer price.

[(b)] (v) The term "NNMS Participant" shall mean [either] an NNMS Market Maker, NNMS ECN, UTP Exchange, or NNMS Order Entry Firm registered as such with the Association for participation in NNMS.

[(f)] (w) The term "NNMS Order Entry Firm" shall mean a member of the Association who is registered as an Order Entry Firm for purposes of participation in NNMS which permits the firm to enter orders [of limited size] for execution against NNMS Market Makers.

(x) The term "Nasdaq Quotation Montage" shall mean the portion of the Nasdaq WorkStation presentation that displays for a particular stock two columns (one for bid, one for offer), under which is listed in price/time priority the MMIDs for each NNMS Market Maker, NNMS ECN, and UTP Exchange registered in the stock and the corresponding quote (price and size) next to the related MMID.

(y) The term "Nasdaq Quoting Market Participant" shall include only the following: (1) NNMS Market Makers; or (2) NNMS ECNs.

(z) The term "odd-lot order" shall mean an order that is for less than a normal unit of trading.

(aa) The term "Preferred Order" shall mean an order that is entered into the Non-Directed Order Process and is designated to be delivered to or executed against a particular Quoting Market Participant's Attributable Quote/Order if the Quoting Market Participant is at the best bid/best offer when the

Preferred Order is the next in line to be executed or delivered. Preferred Orders shall be executed subject to the conditions set out in Rule 4710(b).

(bb) The term "Quote/Order" shall mean a single quotation or shall mean an order or multiple orders at the same price submitted to Nasdaq by a Nasdaq Quoting Market Participant that is displayed in the form of a single quotation. Unless specifically referring to a UTP Exchange's Agency Quote/Order (as set out in Rule 4710(f)(2)(b)), when this term is used in connection with a UTP Exchange, it shall mean the best bid and/or the best offer quotation transmitted to Nasdaq by the UTP Exchange.

(cc) The term "Quoting Market Participant" shall include any of the following: (1) NNMS Market Makers; (2) NNMS ECNs; and (3) UTP Exchange Specialists.

(dd) The term "Reserve Size" shall mean the system-provided functionality that permits a Nasdaq Quoting Market Participant to display in its Displayed Quote/Order part of the full size of a proprietary or agency order, with the remainder held in reserve on an undisplayed basis to be displayed in whole or in part after the displayed part is executed.

(ee) The term "Nasdaq Order Display Facility" shall mean the portion of the Nasdaq WorkStation presentation that displays, without attribution to a particular Quoting Market Participant's MMID, the three best price levels in Nasdaq on both the bid and offer side of the market and the aggregate size of Attributable and Non-Attributable Quotes/Orders at each price level.

(ff) The term "UTP Exchange" shall mean any registered national securities exchange that elects to participate in the NNMS and that has unlisted trading privileges in Nasdaq National Market securities pursuant to the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation and Dissemination Of Quotation and Transaction Information For Exchange-Listed Nasdaq/National Market System Securities Traded On Exchanges On An Unlisted Trading Privilege Basis ("Nasdaq UTP Plan").

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) execution of an NNMS Participant application agreement with the Association;

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

(3) registration as a market maker in The Nasdaq Stock Market pursuant to the Rule 4600 Series and compliance with all applicable rules and operating procedures of the Association and the Commission;

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

(5) acceptance and settlement of each NNMS trade that NNMS identifies as having been effected by such NNMS Market Maker, or if settlement is to be made through another clearing member, guarantee of the acceptance and settlement of such identified NNMS trade by the clearing member on the regularly scheduled settlement date.

(b) Pursuant to Rule 4611(f), participation as an NNMS Market Maker is required for any Nasdaq market maker registered to make a market in an NNMS security.

(c) Participation in NNMS as an NNMS Order Entry Firm requires current registration as such with the Association. Such registration shall be conditioned upon the NNMS Order Entry Firm's initial and continuing compliance with the following requirements:

(1) execution of an NNMS Participant application agreement with the Association;

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

(3) compliance with all applicable rules and operating procedures of the Association and the Securities and Exchange Commission;

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

(5) acceptance and settlement of each NNMS trade that NNMS identifies as having been effected by such NNMS Order Entry Firm or if settlement is to be made through another clearing member, guarantee of the acceptance and settlement of such identified NNMS

trade by the clearing member on the regularly scheduled settlement date.

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

(1) the execution of an NNMS Participant application agreement with the Association;

(2) compliance with all requirements in NASD Rule 4623 and all other applicable rules and operating procedures of the Association and the Securities and Exchange Commission;

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

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

(5) acceptance and settlement of each trade that is executed through the facilities of the NNMS, or if settlement is to be made through another clearing member, guarantee of the acceptance and settlement of such identified NNMS trade by the clearing member on the regularly scheduled settlement date.

[(d)] (e) The registration required hereunder will apply solely to the qualification of an NNMS Participant to participate in NNMS. Such registration shall not be conditioned upon registration in any particular eligible or active NNMS securities.

[(e)] (f) Each NNMS Participant shall be under a continuing obligation to inform the Association of noncompliance with any of the registration requirements set forth above.

(g) The Association and its subsidiaries shall not be liable for any losses, damages, or other claims arising out of the NNMS or its use. Any losses, damages, or other claims, related to a failure of the NNMS to deliver, display, transmit, execute, compare, submit for clearance and settlement, or otherwise process an order, Quote/Order, message, or other data entered into, or created by, the NNMS shall be absorbed by the member, or the member sponsoring the customer, that entered the order, Quote/Order, message, or other data into the NNMS.

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) An NNMS Participant may enter into the NNMS a Non-Directed Order in order to access the best bid/best offer as displayed in Nasdaq.

(B) A Non-Directed Order must be a market or marketable limit order, must be a round lot or a mixed lot, must indicate whether it is a buy, short sale, short-sale exempt, or long sale, and if entered by a Quoting Market Participant may be designated as Immediate or Cancel.

(C) The system will not process a Non-Directed Order to sell short if the execution of such order would violate NASD Rule 3350.

(D) Non-Directed Orders will be processed as described in Rule 4710.

(E) The NNMS shall not accept Non-Directed Orders that are All-or-None, or have a minimum size of execution.

(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) All Non-Directed orders shall be designated as Immediate or Cancel. As such, 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.

(B) A Non-Directed Order that is a limit order may be entered prior to the market's open. Such orders will be held in queue, and if not marketable on the market's open, will be returned to the entering participant.

(b) Directed Orders A participant may enter a Directed Order 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) an "All-or-None" order ("AON") that is at least one normal unit of trading (e.g. 100 shares) in excess of the Attributable Quote/Order of the Quoting Market Participant to which the order is directed; or

(B) a "Minimum Acceptable Quantity" order ("MAQ"), with a MAQ value of at least one normal unit of trading in excess of 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) A Directed Order may have a time in force of 1 to 99 minutes.

(3) Directed Orders shall be processed pursuant to Rule 4710(c).

(c) Entry of Agency and Principal Orders—NNMS Participants are permitted to enter into the NNMS both agency and principal orders for delivery and execution processing.

(d) Order Size—Any round or mixed lot order up to 999,999 shares may be entered into the NNMS for normal execution processing. Odd-lot orders, and the odd-lot portion of a mixed lot, are subject to a separate execution process, as described in Rule 4710(e).

(e) Open Quotes—The NNMS will only deliver an order or an execution to a Quoting Market Participant if that participant has an open quote.

(f) Odd-Lot Orders—The system will accept odd-lot orders for processing through a separate facility. Odd-lot orders must be Non-Directed Orders, and may be market, marketable limit or limit orders. The system shall accept odd-lot orders at a rate no faster than one order per/second from any single participant. Odd-lot orders, and the odd-lot portion of a mixed lot order, shall be processed as described in Rule 4710(e).

4707. Entry and Display of Quotes/Orders

(a) Entry of Quotes/Orders—Nasdaq Quoting Market Participants may enter Quotes/Orders into the NNMS subject to the following requirements and conditions:

(1) Nasdaq Quoting Market Participants shall be permitted to transmit to the NNMS multiple Principal and Agency Quotes/Orders at a single as well as multiple price levels. Such Quote/Order shall indicate whether it is an "Attributable Quote/Order" or "Non-Attributable Quote/Order," and the amount of Reserve Size (if applicable).

(2) Upon entry of a Quote/Order into the system, the NNMS shall time-stamp it, which time-stamp shall determine the ranking of the Quote/Order for purposes of processing Non-Directed Orders as described in Rule 4710(b). For each subsequent size increase received for an existing quote at a given price, the system will maintain the original time-stamp for the original quantity of the quote and assign a separate time-stamp to that size increase.

(3) Consistent with Rule 4613, an NNMS Market Maker is obligated to maintain a two-sided Attributable Quote/Order (other than an Agency

Quote) at all times, for at least one normal unit of trading.

(4) Nasdaq Quoting Market Participants may continue to transmit to the NNMS only their best bid and best offer Attributable Quotes/Orders.

Notwithstanding NASD Rule 4613 and subparagraph (a)(1) of this rule, nothing in these rules shall require a Nasdaq Quoting Market Participant to transmit to the NNMS multiple Quotes/Orders.

(b) Display of Quotes/Orders in Nasdaq—The NNMS will display a Nasdaq Quoting Market Participant's Quotes/Orders as follows:

(1) Attributable Quotes/Orders—The price and size of a Nasdaq Quoting Market Participant's best priced Attributable Quote/Order on both the bid and offer side of the market will be displayed in the Nasdaq Quotation Montage under the Nasdaq Quoting Market Participant's MMID, and also will be displayed in the Nasdaq Order Display Facility as part of the aggregate trading interest at a particular price when the price of such Attributable Quote/Order falls within the best three price levels in Nasdaq on either side of the market. Upon execution or cancellation of the Nasdaq Quoting Market Participant's best-priced Attributable Quote/Order on a particular side of the market, the NNMS will automatically display the participant's next best Attributable Quote/Order on that side of the market.

(2) Non-Attributable Quotes/Orders—The price and size of a Nasdaq Quoting Market Participant's Non-Attributable Quote/Order on both the bid and offer side of the market will be displayed in the Nasdaq Order Display Facility as part of the aggregate trading interest at a particular price when the price of such Non-Attributable Quote/Order falls within the best three price levels in Nasdaq on either side of the market. A Non-Attributable Order will not be displayed in the Nasdaq Quotation Montage under the Nasdaq Quoting Market Participant's MMID. Non-Attributable Quotes/Orders that are the best priced Non-Attributable bids or offers in the system will be displayed in the Nasdaq Quotation Montage under an anonymous MMID, which shall represent and reflect the aggregate size of all Non-Attributable Quotes/Orders in Nasdaq at that price level. Upon execution or cancellation of a Nasdaq Quoting Market Participant's Non-Attributable Quote/Order, the NNMS will automatically display a Non-Attributable Quote/Order in the Nasdaq Order Display Facility (consistent with the parameters described above) if it falls within the best three price levels in Nasdaq on either side of the market.

(c) *Reserve Size*—Reserve Size shall not be displayed in Nasdaq, but shall be electronically accessible as described in Rule 4710(b).

(d) *Summary Scan*—The “Summary Scan” functionality, which is a query-only non-dynamic functionality, displays without attribution to Quoting Market Participants’ MMIDs the aggregate size of Attributable and Non-Attributable Quotes/Orders for all levels (on both the bid and offer side of the market) below the three price levels displayed in the Nasdaq Order Display Facility.

(e) *NQDS Prime*—“NQDS Prime” is a separate data feed that Nasdaq will make available for a fee that is approved by the Securities and Exchange Commission. This separate data feed will display with attribution to Quoting Market Participants’ MMIDs all Attributable Quotes/Orders on both the bid and offer side of the market for the price levels that are disseminated in the Nasdaq Order Display Facility.

4710. Participant Obligations in NNMS

(a) *Registration*—Upon the effectiveness of registration as a NNMS Market Maker, NNMS ECN, 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) [Market Makers] *Non-Directed Orders*

(1) [An NNMS Market Maker] *General Provisions*—A Quoting Market Participant in an NNMS Security shall be subject to the following requirements for Non-Directed Orders:

(A) *Obligations*—For each NNMS security in which it is registered [as an NNMS Market Maker, the market maker], a Quoting Market Participant must accept and execute individual Non-Directed Orders against its quotation including its Agency Quote (if applicable), in an amount equal to or smaller than the combination of the Displayed [quotation] Quote/Order and Reserve Size (if applicable) of such [quotation(s)] Quote/Order, when the Quoting Market Participant is at the best bid/best offer in Nasdaq. [For purposes of this rule, the term “reserved size” shall mean that a NNMS Market Maker or a customer thereof wishes to display publicly part of the full size of its order or interest with the remainder held in reserve on an undisplayed basis to be

displayed in whole or in part as the displayed part is executed. To utilize the reserve size function, a minimum of 1,000 shares must initially be displayed in the market maker’s quote (including the Agency Quote), and the quotation must be refreshed to 1,000 shares consistent with subparagraph (b)(2)(A) of this rule.] Quoting Market Participants shall participate in the NNMS as follows:

(i) NNMS Market Makers and NNMS Auto-Ex ECNs shall participate in the automatic-execution functionality of the NNMS, and shall accept the delivery of an execution up to the size of the participant’s Displayed Quote/Order and Reserve Size.

(ii) NNMS Order-Delivery ECNs shall participate in the order-delivery functionality of the NNMS, and shall accept the delivery of an order up to the size of the NNMS Order-Delivery ECN’s Displayed Quote/Order and Reserve Size. The NNMS Order-Delivery ECN shall be required to execute such order in a manner consistent with the Firm Quote Rule.

(iii) UTP Exchanges that choose to participate in the NNMS shall do so as described in subparagraph (f) of this rule and as otherwise described in the NNMS rules and the UTP Plan.

(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 in queue to receive an order is (based on the algorithm selected by the entering participant, as described in subparagraph (b)(B) (i)–(iii) of this rule), and shall deliver an execution to Quoting Market Participants 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; provided however, that the system always shall deliver an order (in lieu of an execution) to the Quoting Market Participant next in queue when the participant that entered the Non-Directed Order into the system is a UTP Exchange that does not provide automatic execution against its Quotes/Orders for Nasdaq Quoting Market Participants and NNMS Order Entry Firms. Non-Directed Orders entered into the NNMS system shall be delivered to or automatically executed against Quoting Market Participants’ Displayed [quotations] Quotes/Orders and Reserve Size, including Agency Quotes (if applicable), in strict price/time priority, as described in the algorithm contained in subparagraph (b)(B)(i) of this rule [For quotes at the same price, the system will yield priority to all displayed

quotations over reserve size, so that the system will execute against Displayed quotations in time priority and then against reserve size in time priority]. Alternatively, an NNMS Market Participant can designate that its Non-Directed Orders be executed based on a price/time priority that considers ECN quote-access fees, as described in subparagraphs (b)(B)(ii) of this rule, or executed based on price/size/time priority, as described in subparagraph (b)(B)(iii) of this rule.

(i) *Default Execution Algorithm—Price/Time*—The system will default to a strict price/time priority within Nasdaq, and will attempt to access interest in the system in the following priority and order:

(a) Displayed Quotes/Orders of NNMS Market Makers, NNMS ECNs, and Non-Attributable Agency Quotes/Orders of UTP Exchanges (as permitted by subparagraph (f) of this rule), in time priority between such participants’ Quotes/Orders.

(b) Reserve Size of Nasdaq Quoting Market Participants, in time priority between such participants’ Quotes/Orders; and

(c) Principal Quotes/Orders of UTP Exchanges, in time priority between such participants’ Quotes/Orders.

(ii) *Price/Time Priority Considering Quote-Access Fees*—If this options is chosen, the system will attempt to access interest in the system in the following priority and order:

(a) Displayed Quotes/Orders of NNMS Market Makers, NNMS ECNs that do not charge a separate quote-access fee to non-subscribers, and Non-Attributable Agency Quotes/Orders of UTP Exchanges (as permitted by subparagraph (f) of this rule), as well as Quotes/Orders from NNMS ECNs that charges a separate quote-access fee to non-subscribers where the ECN entering such Quote/Order indicates that the price improvement offered by the specific Quote/Order is equal to or exceeds the separate quote-access fee the ECN charges, in time priority between such participants’ Quotes/Orders;

(b) Displayed Quotes/Orders of NNMS ECNs that charge a separate quote-access fee to non-subscribers, in time priority between such participants’ Quotes/Orders;

(c) Reserve Size of NNMS Market Makers and NNMS ECNs that do not charge a separate quote-access fee to non-subscribers, as well as Reserve Size of Quotes/Orders from NNMS ECNs that charges a separate quote-access fee to non-subscribers where the ECN entering such Quote/Order has indicated that the price improvement offered by the

specific Quote/Order is equal to or exceeds the separate quote-access fee the ECN charges, in time priority between such participants' Quotes/Orders;

(d) Reserve Size of NNMS ECNs that charge a separate quote-access fee to non-subscribers, in time priority between such participants' Quotes/Orders; and

(e) Principal Quotes/Orders of UTP Exchanges, in time priority between such participants' Quotes/Orders.

(iii) Price/Size Priority—If this option is chosen, Non-Directed Orders shall be executed in price/size/time priority against:

(a) Displayed Quotes/Orders of NNMS Market Makers, NNMS ECNs, and Non-Attributable Agency Quotes/Orders of UTP Exchanges (as permitted by subparagraph (f) of this rule), in price/size/time priority between such participants' Quotes/Orders;

(b) the Reserve Size of Nasdaq Quoting Market Participants, in price/size/time priority between such participants' Quotes/Orders, which size priority shall be based on the size of the Displayed Quote/Order, and not on the amount held in Reserve Size; and

(c) Principal Quotes/Orders of UTP Exchanges, in price/size/time priority between such participants' Quotes/Orders.

(iv) Exceptions—The following exceptions shall apply to the above execution parameters:

(a) If a Nasdaq Quoting Market Participant enters a Non-Directed Order into the system, before sending such Non-Directed Order to the next Quoting Market Participants in queue, the NNMS will first attempt to match off the order against the Nasdaq Quoting Market Participant's own Quote/Order if the participant is at the best bid/best offer in Nasdaq.

(b) If an NNMS Market Participant enters a Preferred Order, the order shall be executed against (or delivered in an amount equal to) both the Displayed Quote/Order and Reserve Size of the Quoting Market Participant to which the order is being directed, if that Quoting Market Participant is at the best bid/best offer when the Preferred Order is next in line to be delivered (or executed). Any unexecuted portion of a Preferred Order shall be returned to the entering NNMS Market Participant. If the Quoting Market Participant is not at the best bid/best offer when the Preferred Order is next in line to be delivered (or executed), the Preferred Order shall be returned to the entering NNMS Market Participant.

(C) Decrementation Procedures—The size of a [displayed quotation] 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 [n NNMS] Non-Directed [o] Order or Preferred Order in an amount equal to [or greater than one normal unit of trading] the system-delivered order or execution; provided, however, that [the execution of] if an NNMS order that is a mixed lot, the system will only deliver a Liability Order or an execution for the number of round lots contained in the mixed lot order, and will only decrement [a displayed quotation's] the size of a Displayed Quote/Order by the number of shares represented by the number of round lots contained in the mixed lot order. The odd-lot portion of the mixed lot will be executed at the same price against the NNMS Market Maker next in the odd lot rotation, as described in subparagraph (e) of this rule.

(i) If an NNMS Auto-Ex ECN has its bid or offer Attributable Quote/Order and Reserve Size decremented to zero without transmission of another Attributable Quote/Order to Nasdaq, the system will zero out the side of the quote that is exhausted. If both the bid and offer are decremented to zero without transmission of a revised Attributable Quote/Order, the ECN will be placed into an excused withdrawal state until the ECN transmits to Nasdaq a revised Attributable Quote/Order.

(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 in queue. The system then will zero out the ECN's Quote/Orders at that price level on that side of the market, 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) If an NNMS ECN's Quote/Order has been zeroed out or if the ECN has been placed into excused withdrawal as described in subparagraphs (b)(1)(C)(i) and (ii) of this rule, the system will continue to access the ECN's Non-

Attributable Quotes/Orders that are in the NNMS, as described in Rule 4707 and subparagraph (b) of this rule.

(iv) If an NNMS ECN regularly fails to meet a 5-second response time (as measured by the ECN's Service Delivery Platform) over a period of orders, such that the failure endangers the maintenance of a fair and orderly market, Nasdaq will place that ECN's quote in a closed-quote state. Nasdaq will lift the closed-quote state when the NNMS ECN certifies that it can meet the 5-second response time requirement with regularity sufficient to maintain a fair and orderly market.

(D) Interval Delay—After the NNMS system has executed all Displayed Quotes/Orders and Reserve Size interest at a price level [an order against a market maker's displayed quote and reserve size (if applicable), that market maker shall not be required to execute another order at its bid or offer in the same security until a predetermined time period has elapsed from the time the order was executed, as measured by the time of execution in the Nasdaq system. This period of time shall initially be established as 5 seconds, but may be modified upon Commission approval and appropriate notification to NNMS participants.], the following will occur:

(i) If the NNMS system cannot execute in full all shares of a Non-Directed Order against the Displayed Quotes/Orders and Reserve Size interest at the initial price level and at price two minimum trading increments away, the system will pause for 5 seconds before accessing the interest at the next price level in the system; provided, however, that once the Non-Directed Order can be filled in full within two price levels, there will be no interval delay between price levels and the system will execute the remainder of order in full; or

(ii) If the Non-Directed Orders is specially designated by the entering market participant as a "sweep order," the system will execute against all Displayed Quotes/Orders and Reserve Size at the initial price level and the two price levels being displayed in the Nasdaq Order Display Facility without pausing between the displayed price levels. Thereafter, the system will pause 5 seconds before moving to the next price level, until the Non-Directed Order is executed in full.

(iii) The interval delay described in this subparagraph may be modified upon Commission approval and appropriate notification to NNMS Participants.

(E) All entries in NNMS shall be made in accordance with the requirements set

forth in the NNMS User Guide, as published from time to time by Nasdaq.

(2) Refresh Functionality

(A) Reserve Size Refresh—Once a Nasdaq Quoting Market Participant's [an NNMS Market Maker's displayed quotation] *Displayed Quote/Order* size on either side of the market in the security has been decremented to zero due to NNMS [executions] *processing* Nasdaq will refresh the [market maker's] displayed size out of Reserve Size to a size-level designated by the *Nasdaq Quoting Market Participant* [NNMS Market Maker], or in the absence of such size-level designation, to the automatic refresh size. [If the market maker is using the reserve size function for its proprietary quote or Agency Quote the NNMS Market Maker must refresh to a minimum of 1,000 shares, consistent with subparagraph (b)(1)(A) of this rule]. *To utilize the Reserve Size functionality, a minimum of 1,000 shares must initially be displayed in the Nasdaq Quoting Market Participant's Displayed Quote/Order, and the Displayed Quote/Order must be refreshed to at least 1,000 shares. This functionality will not be available for use by UTP Exchanges.*

(B) [Auto q]Quote Refresh ("QR")—Once an NNMS Market Maker's *Displayed Quote/Order* [quotation] size and Reserve Size on either side of the market in the security has been decremented to zero due to NNMS executions, the NNMS Market Maker may elect to have The Nasdaq Stock Market refresh the market maker's quotation as follows:

(i) Nasdaq will refresh the market maker's quotation price on the bid or offer side of the market, whichever is decremented to zero, by a[n] price interval designated by the NNMS Market Maker; and

(ii) Nasdaq will refresh the market maker's displayed size to a level designated by the NNMS Market Maker, or in the absence of such size level designation, to the automatic refresh size. [A Market Maker's Agency Quotation shall not be subject to the functionality described in this subparagraph.]

(iii) *This functionality shall produce an Attributable Quote/Order. In addition, if an NNMS Market Maker is utilizing the QR functionality but has an Attributable Quote/Order in the system that is priced at or better than the quote that would be created by the QR, the NNMS will display the Attributable Quote/Order, not the QR-produced quote.*

(iv) *An NNMS Market Maker's Agency Quote shall not be subject to the functionality described in this subparagraph, nor shall this*

functionality be available to Quoting Market Participants other than NNMS Market Makers.

(3) *Entry of Locking/Crossing Quotes/Orders* [Except as otherwise provided in subparagraph (b)(10) of this rule, at any time a locked or crossed market, as defined in Rule 4613(e), exists for an NNMS security, a market maker with a quotation for that security (including an Agency Quote) that is causing the locked or crossed market may have orders representing shares equal to the size of the bid or offer that is locked or crossed executed by the NNMS system against the market maker's quote (including an Agency Quote) at the quoted price if that price is the best price. During locked or crossed markets, the NNMS system will execute orders against those market makers that are locked or crossed in predetermined time intervals. This period of time initially shall be established as five (5) seconds, but may be modified upon approval by the Commission and appropriate notification to NNMS participants.] *The system shall process locking/crossing Quotes/Orders as follows:*

(A) *Locked/Crossed Quotes/Orders During Market Hours—If during market hours, a Quoting Market Participant enters into the NNMS a Quote/Order that will lock/cross the market (as defined in NASD Rule 4613(e)), the system will not display the Quote/Order as a quote in Nasdaq; instead the system will treat the Quote/Order as a marketable limit order and enter it into the system as a Non-Directed Order for processing (consistent with subparagraph (b) of this rule) as follows:*

(i) *For locked-market situations, the order will be routed to the Quoting Market Participant next in queue who would be locked, and the order will be executed (or delivered for execution) at the lock price;*

(ii) *For crossed-market situations, the order will be entered into the system and routed to the next Quoting Market Participant in queue who would be crossed, and the order will be executed (or delivered for execution) at the price of the Displayed Quote/Order that would have been crossed.*

Once the lock/cross is cleared, if the participant's order is not completely filled, the system will reformat the order and display it in Nasdaq (consistent with the parameters of the Quote/Order) as a Quote/Order on behalf of the entering Quoting Market Participant.

(B) *Locked/Crossed Quotes/Orders at the Open—If the market is locked or crossed at 9:30 a.m., Eastern Time, the NNMS will clear the locked and/or crossed Quotes/Order by executing (or delivering for execution) the oldest*

bid(offer) against the oldest offer(bid) against which it is marketable at the price of the oldest Quote/Order. Nasdaq then will begin processing Non-Directed Orders as described in subparagraph (b) of this rule.

[(4) For each NNM security in which a market maker is registered, the market maker may enter orders into the NNMS for its proprietary account as well as on an agency or riskless principal basis.]

[(5)] (4) An NNMS Market Maker may terminate its obligation by keyboard withdrawal (or its equivalent) from NNMS at any time. However, the market maker has the specific obligation to monitor its status in NNMS to assure that a withdrawal has in fact occurred. Any transaction occurring prior to the effectiveness of the withdrawal shall remain the responsibility of the market maker.

[(6)] (5) [An NNMS Market Maker will be suspended from NNMS if its bid or offer has been decremented to zero due to NNMS executions and will be permitted a standard grace period, the duration of which will be established and published by the Association, within which to take action to restore a two-sided quotation in the security for at least one normal unit of trading. An NNMS Market Maker that fails to reenter a two-sided quotation within the allotted time will be deemed to have withdrawn as a market maker ("Timed Out of the Box"). Except as provided below in this subparagraph and in subparagraph (b)(7) of this rule, an NNMS Market Maker that withdraws in an NNM security may not re-register as a market maker in that security for twenty (20) business days.] *If an NNMS Market Maker's Attributable Quote/Order is reduced to zero on one side of the market due to NNMS executions, the NNMS will close the Market Maker's quote in the NNMS with respect to both sides of its market, and the NNMS Market Maker will be permitted a grace period of three minutes within which to take action to restore its Attributable Quote/Order, if the market maker has not authorized use of the QR functionality or does not otherwise have an Attributable Quote/Order on both sides of the market in the system. An NNMS Market Maker that fails to transmit an Attributable Quote/Order in a security within the allotted time will have its quotation restored by the system at the lowest bid price and the highest offer price in that security. Except as provided in subparagraph (b)(6) of this rule, an NNMS Market Maker that withdraws from a security may not re-register in the system as a market maker in that security for twenty (20) business days. The requirements of*

this subparagraph shall not apply to a market maker's Agency Quote.

[(A) Notwithstanding the above, a market maker can be reinstated if:

(i) the market maker makes a request for reinstatement to Nasdaq Market Operations as soon as practicable under the circumstances, but within at least one hour of having been Timed Out of the Box, and immediately thereafter provides written notification of the reinstatement request;

(ii) it was a Primary Market Maker at the time it was Timed Out of the Box;

(iii) the market maker's firm would not exceed the following reinstatement limitations:

a. for firms that simultaneously made markets in less than 250 stocks during the previous calendar year, the firm can receive no more than four (4) reinstatements per year;

b. for firms that simultaneously made markets in 250 or more but less than 500 stocks during the previous calendar year, the firm can receive no more than six (6) reinstatements per year;

c. for firms that simultaneously made markets in 500 or more stocks during the previous calendar year, the firm can receive no more than twelve (12) reinstatements per year; and

(iv) the designated Nasdaq officer makes a determination that the withdrawal was not an attempt by the market maker to avoid its obligation to make a continuous two-sided market. In making this determination, the designated Nasdaq officer will consider, among other things:

a. whether the market conditions in the issue included unusual volatility or other unusual activity, and/or the market conditions in other issues in which the market maker made a market at the time the firm was Timed Out of the Box;

b. the frequency with which the firm has been Timed Out of the Box in the past;

c. procedures the firm has adopted to avoid being inadvertently Timed Out of the Box; and

d. the length of time before the market maker sought reinstatement.

(B) If a market maker has exhausted the reinstatement limitations in subparagraph (b)(6)(A)(iii) above, the designated Nasdaq officer may grant a reinstatement request if he or she finds that such reinstatement is necessary for the protection of investors or the maintenance of fair and orderly markets and determines that the withdrawal was not an attempt by the market maker to avoid its obligation to make a continuous two-sided market in instances where:

(i) a member firm experiences a documented problem or failure impacting the operation or utilization of any automated system operated by or on behalf of the firm (chronic system failures within the control of the member will not constitute a problem or failure impacting a firm's automated system) or involving an automated system operated by Nasdaq;

(ii) the market maker is a manager or co-manager of a secondary offering from the time the secondary offering is announced until ten days after the offering is complete; or

(iii) absent the reinstatement, the number of market makers in a particular issue is equal to two (2) or less or has otherwise declined by 50% or more from the number that existed at the end of the prior calendar quarter, except that if a market maker has a regular pattern of being frequently Timed Out of the Box, it may not be reinstated notwithstanding the number of market makers in the issue.]

[(7)] (6) Notwithstanding the provisions of subparagraph [(6)] (5) above:

(A) an NNMS Market Maker that obtains an excused withdrawal pursuant to Rule 4619 prior to withdrawing from NNMS may reenter NNMS according to the conditions of its withdrawal; and

(B) a NNMS Market Maker that fails to maintain a clearing arrangement with a registered clearing agency or with a member of such an agency, and is thereby withdrawn from participation in ACT and NNMS for NNMS securities, may reenter NNMS after a clearing arrangement has been reestablished and the market maker has complied with ACT participant requirements. Provided however, that if the Association finds that the ACT market maker's failure to maintain a clearing arrangement is voluntary, the withdrawal of quotations will be considered voluntary and unexcused.

[(8)] (7) The Market Operations Review Committee shall have jurisdiction over proceedings brought by market makers seeking review of their removal from NNMS pursuant to subparagraph[s] (b)(5) [(6) or (b)(7)] of this rule.

[(9)] (8) In the event that a malfunction in the [NNMS Market Maker's] *Quoting Market Participant's* equipment occurs, rendering [on-line] communications with NNMS inoperable, the [NNMS Market Maker] *Quoting Market Participant* is obligated to immediately contact Nasdaq Market Operations by telephone to request withdrawal from NNMS *and a closed-quote status*, and *if the Quoting Market Participant is an NNMS Market Maker*

an excused withdrawal from Nasdaq[. Such request must be made] pursuant to Rule 4619. If withdrawal is granted, Nasdaq Market Operations personnel will enter the withdrawal notification into NNMS from a supervisory terminal and shall close the quote. Such manual intervention, however, will take a certain period of time for completion and, *unless otherwise permitted by the Association pursuant to its authority under Rule 11890*, the [NNMS Market Maker] *Quoting Market Participant* will continue to be obligated for any transaction executed prior to the effectiveness of [his] *the* withdrawal and *closed-quote status*.

[(10) In the event that there are no NNMS Market Makers at the best bid (offer) disseminated by Nasdaq, market orders to sell (buy) entered into NNMS will be held in queue until executable, or until 90 seconds has elapsed, after which such orders will be rejected and returned to their respective order entry firms.]

(c) *Directed Order Processing*—A participant may enter a Directed Order into the NNMS to access a specific Quote/Order in the Nasdaq Quotation Montage and to begin the negotiation process with a particular Quoting Market Participant. The system will deliver an order (not an execution) to the Quoting Market Participant designated as the recipient of the order. Upon delivery, the Quoting Market Participant shall owe no liability under the Firm Quote Rule to that order, 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 (as described in Rule 4706(b)). Additionally, upon delivery, the system will not decrement the receiving Quoting Market Participant's Quote/Order. This provision shall not apply to Preferred Orders.

[(c)] (d) NNMS Order Entry Firms

All entries in NNMS shall be made in accordance with the procedures and requirements set forth in the NNMS User Guide. Orders may be entered in NNMS by the NNMS Order Entry Firm through either its Nasdaq terminal or computer interface. The system will transmit to the firm on the terminal screen and printer, if requested, or through the computer interface, as applicable, an execution report generated immediately following the execution.

[(d)] Order Entry Parameters

(1) NNMS will only accept market and marketable limit orders for execution and will not accept market or

marketable limit orders designated as All-or-None ("AON") orders; provided, however, that NNMS will not accept any limit orders, marketable or unmarketable, prior to 9:30 a.m., Eastern Time. For purposes of this subparagraph, an AON order is an order for an amount of securities equal to the size of the order and no less.

(2) Additionally, the NNMS will only accept orders that are unpreferred, thereby resulting in execution in rotation against NNMS Market Makers, and will not accept preferred orders.

(3) NNMS will not accept orders that exceed 9,900 shares, and no participant in the NNMS system shall enter an order into the system that exceeds 9,900.]

[(e) Electronic Communication Networks

An Electronic Communications Networks, as defined in SEC Rule 11Ac1-1(a)(8), may participate in the NNMS System if it complies with NASD Rule 4623 and executes with the Association a Nasdaq Workstation Subscriber Agreement, as amended, for ECNs.]

(e) Odd-Lot Processing

(1) Participation in Odd-Lot Process—All NNMS Market Makers may participate in the Odd-Lot Process for each security in which the market maker is registered.

(2) Execution Process

(A) Odd-lot orders will be executed against an NNMS Market Maker only if it has an odd-lot exposure limit in an amount that would fill the odd-lot order. A NNMS Market Maker may, on a security-by-security basis, set an odd-lot exposure limit from 0 to 999,999 shares.

(B) An odd-lot order shall be executed automatically against the next available NNMS Market Maker when the odd-lot order becomes executable (i.e., when the best price in Nasdaq moves to the price of the odd-lot limit order). Such odd-lot orders will execute at the best price available in the market, in rotation against NNMS Market Makers who have an exposure limit that would fill the odd-lot order.

(C) For odd lots that are part of a mixed lot, once the round-lot portion is executed, the odd-lot portion will be executed at the round-lot price against the next NNMS Market Maker in rotation (as described in subparagraph (e)(2)(b) of this rule) even if the round-lot price is no longer the best price in Nasdaq.

(D) Odd-lot executions will decrement the odd-lot exposure limit of an NNMS Market Maker but will not decrement the size of NNMS Market Maker's Displayed Quote/Order.

(E) After the NNMS system has executed an odd lot against an NNMS Market Maker, the system will not deliver another odd-lot order against the same market maker until a predetermined time period has elapsed from the time the last execution was delivered, as measured by the time of execution in the Nasdaq system. This period of time shall initially be established as 5 seconds, but may be increased upon Commission approval and appropriate notification to NNMS Participants or may be decreased to an amount less than five seconds by the NNMS Market Maker.

(f) UTP Exchanges

Participation in the NNMS by UTP Exchanges is voluntary. If a UTP Exchange elects to participate in the system, Nasdaq shall endeavor to provide fair and equivalent access to the Nasdaq market for UTP Exchanges, as a UTP Exchange provides to its market for Nasdaq Quoting Market Participants and NNMS Order Entry Firms. The following provisions shall apply to UTP Exchanges that choose to participate in the NNMS:

(1) Order Entry—UTP Exchanges that elect to participate in the system shall be permitted to enter Directed and Non-Directed Orders into the system subject to the conditions and requirements of Rules 4706. Directed and Non-Directed Orders entered by UTP Exchanges shall be processed (unless otherwise specified) as described in subparagraphs (b) and (c) of this rule.

(2) Display of UTP Exchange Quotes/Orders in Nasdaq

(A) UTP Exchange Principal Orders/Quotes—UTP Exchanges that elect to participate in the system shall be permitted to transmit to the NNMS a single bid Quote/Order and a single offer Quote/Order. Upon transmission of the Quote/Order to Nasdaq, the system shall time stamp the Quote/Order, which time stamp shall determine the ranking of the Quote/Order for purposes of processing Non-Directed Orders. The NNMS shall display the best bid and best offer Quote/Order transmitted to Nasdaq by a UTP Exchange in the Nasdaq Quotation Montage under the MMID for the UTP Exchange, and shall also display such Quote/Order in the Nasdaq Order Display Facility as part of the aggregate trading interest when the UTP Exchange's best bid/best offer Quote/Order falls within the best three price levels in Nasdaq on either side of the market.

(B) UTP Exchange Agency Quotes/Orders

(i) A UTP Exchange that elects to participate in the system may transmit to the NNMS Quotes/Orders at a single

as well as multiple price levels that meet the following requirements: are not for the benefit of a broker and/or dealer that is with respect to the UTP Exchange a registered or designated market maker, dealer or specialist in the security at issue; and are designated as Non-Attributable Quotes/Orders ("UTP Agency Order/Quote").

(ii) Upon transmission of a UTP Agency Quote/Order to Nasdaq, the system shall time stamp the order, which time stamp shall determine the ranking of these Quote/Order for purposes of processing Non-Directed Orders, as described in subparagraph (b) of this rule. A UTP Agency Quote/Order shall not be displayed in the Nasdaq Quotation Montage under the MMID for the UTP Exchange. Rather, UTP Agency Quotes/Orders shall be reflected in the Nasdaq Order Display Facility and Nasdaq Quotation Montage in the same manner in which Non-Attributable Quotes/Orders from Nasdaq Quoting Market Participants are reflected in Nasdaq, as described in Rule 4707(b)(2).

(3) Non-Directed Order Processing

(a) UTP Exchanges that elect to participate in the system and that agree to provide automatic execution against their Quotes/Orders for Nasdaq Quoting Market Participants and NNMS Order Entry Firms, shall accept an execution of an order up to the size of the UTP Exchange's displayed Quote/Order, and shall have Non-Directed Orders they enter into the system processed as described in subparagraph (b) of this rule.

(b) UTP Exchanges that elect to participate in the system but that do not provide automatic execution against their Quotes/Orders for Nasdaq Quoting Market Participants and NNMS Order Entry Firms, shall accept the delivery of an order up to the size of the UTP Exchange's Displayed Quote/Order, and shall have Non-Directed Orders they enter into the system processed as described in subparagraph (b) of this rule. If such a UTP Exchange declines or partially fills a Non-Directed Order without immediately transmitting to Nasdaq a revised Quote/Order that is at a price inferior to the previous price, or if such a UTP Exchange fails to respond in any manner within 30 seconds of order delivery, the NNMS will send the order (or remaining portion thereof) back into the system for delivery to the next Quoting Market Participant in queue. The system will then move the side of such UTP Exchange's Quote/Order to which the declined or partially-filled order was delivered, to the lowest bid or highest offer price in Nasdaq, at a size of 100 shares.

(4) *Directed Order Processing*—UTP Exchanges that elect to participate in the system shall participate in the Directed Order processing as described in subparagraph (c) of this rule.

(5) *Decrementation*—UTP Exchanges shall be subject to the decrementation procedures described in subparagraph (b) of this rule.

(6) *Scope of Rules*—Nothing in these rules shall apply to UTP Exchanges that elect not to participate in the system.

4711–4714—No Change.

4718. Termination of System Service

The Association or its subsidiaries may, upon notice, terminate system service to a participant in the event that a participant fails to abide by any of the rules or operating procedures of the System or any other relevant rule or requirement, or fails to pay promptly for services rendered.

* * * * *

4750. SMALLCAP SMALL ORDER EXECUTION SYSTEM (SOES)

4751–4757—Deleted.

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

In its filing with the Commission, the NASD 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. The NASD 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

As stated in the original filing, some of the primary goals of the Nasdaq Order Display Facility (also known as the "SuperMontage") are to expand the amount of market information available to the investing public, and to make that trading interest more accessible. The SuperMontage seeks to reduce market fragmentation and address the informational and competitive disparities that exist in the NASD's current market structure. As an open and competitive market, the NASD is committed to creating a trading environment where diverse pools of liquidity can be viewed and accessed on

fair and equal terms.¹² To achieve this goal, Nasdaq has crafted a system that fairly balances the needs and business models of all market participants. In response to comments received on Amendment No. 7, the NASD proposes the following changes and modifications to the SuperMontage. The NASD believes that the proposed amendments will further enhance the information available to market participants, and provide greater choice for market participants.

a. *Non-Directed Order Processing*. 1. *History*. As originally proposed, the SuperMontage would execute non-directed orders in general price/time priority.¹³ In response to concerns raised by SEC staff relating to best execution, the NASD proposed to change the Order Execution Algorithm to account for ECNs fees in Amendment No. 4.¹⁴ Specifically, in Amendment No. 4, The NASD proposed that within a price level, a non-directed order would be executed against ECNs, market makers, UTP Exchange agency interest, in strict time priority, unless an ECN charged separate quote-access fee ("charging ECNs"). Pursuant to Amendment No. 4, charging-ECNs would be executed after market makers, ECNs that do not charge a quote-access fee ("non-charging ECNs"), and agency interest of UTP Exchanges. The logic behind Amendment No. 4 was that an ECN's fee represents an increase in trading costs and thus the quote of the access-fee charging ECN represents an inferior price when compared to same-priced quotes of market participants that do not charge a fee.

In response to Amendment No. 4, some commenters claimed that charging ECNs should not be prioritized in the aforementioned manner because this was generally unfair. In response to these comments, the Commission suggested that ECNs could address the quote-access fee issue by reflecting the access fee in their public quote. As a result, in Amendment No. 6, the NASD proposed to give ECNs that include the separate quote-access fee in their quote equal priority to same-priced orders

representing market makers, non-charging ECNs, and the agency interest of UTP Exchanges assuming the related legal, technology, and policy issues were resolved. In response to Amendment No. 6, however, some ECNs claimed that including the fee in the quote would not completely resolve their concerns, in part, because ECNs may offer price improvement above the quote as a result of rounding. Accordingly, in Amendment No. 7, the NASD proposed to give charging ECNs the ability to indicate on an order-by-order basis whether the price improvement offered by the order exceeded the quote-access fee charged. Pursuant to Amendment No. 7, if the price improvement exceeded the quote-access fee, Nasdaq would rank that order, for execution purposes, with the same-priced orders of market makers, non-charging ECNs, and non-attributable agency interest of UTP Exchanges. In Amendment No. 8, the NASD clarifies that if the price improvement is equal to or exceeds the separate quote-access fee, Nasdaq would rank that quote/order with equally priced quotes/orders from Nasdaq Quoting Market Participants that do not charge a separate quote access fee. Some commenters to Amendment Nos. 6 and 7 still were not satisfied with the proposed two solutions regarding ECN quote-access fees.

2. *Proposed Changes to Non-Directed Order Process*. The NASD understands that factors other than cost or quote-access fees may be important to a market participant in making investment decisions. Further, the NASD believes that market participants should be given a choice in determining how to best execute their customer or proprietary orders. With this in mind, and in response to the comments to Amendment No. 7, the NASD proposes to amend the Order Execution Algorithm for non-directed orders. The NASD proposes a more flexible approach—one that should empower market participants to make an informed choice about how best to interact with the market. The goal of this aspect of Amendment No. 8 is to give market participants more choice and flexibility as to how their customer and proprietary orders should be processed. While best execution concerns drove the changes to the Order Execution Algorithm in previous amendments, the NASD realizes that a "one-size-fits-all" approach may not meet every market participant's needs in all situations. While some commenters continue to advocate a single Order Execution Algorithm where strict price/

¹² For example, Nasdaq is committed to the creation of SuperMontage fee structure that does not discriminate between Nasdaq market participants that interact with the system on an order-delivery versus an automatic execution basis. Nasdaq shall also endeavor to avoid systemic biases, including biases that result from differential fees or incentives between quotes and orders, whether they are directed, non-directed, or preferred.

¹³ Generally, a non-direct order is an order that is not designated to be sent to a particular market or ECN.

¹⁴ We note that Commission staff and at least one commentator raised concerns about ECN fees and best execution. See e.g., ITG Letter.

time priority is the rule, the NASD is initially concerned that this type of algorithm might impose a needlessly rigid structure similar to a central limit order book ("CLOB"). To be sure, the SuperMontage is not a CLOB. Additionally, a strict price/time priority (without choice) would force the public investor to pay ECN quote-access fees, thus squashing the voice of the investor and competition. The NASD believes that market participants and investors would be best served, and in fact empowered, by a market model that gives participants a choice of how their orders are to be processed. The NASD believes that choice is key.

To be more specific, the NASD proposes to give the SuperMontage participants that enter non-directed orders three options as to how their order would interact with the quotes/orders in Nasdaq. Specifically, orders could be executed on: (1) Strict price/time priority; (2) price/size/time priority; and (3) price/time priority that accounts for ECN quote-access fees. Pursuant to Amendment No. 8, the SuperMontage would be programmed to a default Order Execution Algorithm based on strict price/time priority within Nasdaq. Thus, unless a market participant overrode the default algorithm by selecting one of the alternative algorithms (with specific instructions), non-directed orders would be executed as follows: (1) Displayed quotes/order of market makers, ECNs, and non-attributable agency interest of UTP Exchanges, in time priority between such interest; (2) reserve size of market makers and ECNs in time priority between such interest; and (3) principal quotes of UTP Exchanges, in time priority between such interest.

As a second option, a market participant would be able to indicate that their orders be executed on a price/size/time basis. Under the second option, non-directed orders at a particular price level would execute against displayed quotes and then reserve size based on the size of the displayed quote, and then time if there is a tie in size. Reserve size would be executed based on the size of the related displayed quote, not the total amount held in reserve. Under this option, orders would be processed as followed: (1) Displayed quotes/orders of market makers, ECNs, and agency interest of UTP Exchanges in price/size/time priority between such interest; (2) reserve size of market makers and ECNs, in price/size/time priority of such interest, with size priority based on the size of the related displayed quote/order; and (3) principal quotes of UTP

Exchanges, in price/size/time priority between such interest.

As a third choice, a market participant would be able to indicate that their order should be executed in a manner that accounts for an ECN's separate quote-access fee. This algorithm is similar to the algorithm proposed in Amendment No. 7. If a market participant selects this option, non-directed orders would be executed as follows: (1) Displayed quotes/orders of market makers, ECNs that do not charge a separate quote-access fee, and non-attributable agency interest of UTP Exchanges, as well as quotes/orders of ECNs that charges a separate quote-access fee where the ECN indicates that the price improvement offered by the quote/order is equal to or exceeds the quote-access fee, in time priority between such interest; (2) displayed quotes/orders of ECNs that charge a separate quote-access fee to non-subscribers; (3) reserve size of market makers and ECNs that do not charge a separate quote-access fee to non-subscribers, as well as reserve size of quotes/orders from ECNs that charge a separate quote-access fee to non-subscribers where the ECN entering such quote/order has indicated that the price improvement offered is equal to or exceeds the quote-access fee, in time priority between such interest; (4) reserve size of ECNs that charge a separate quote-access fee to non-subscribers, in time priority between such interest; and (5) principal interest of UTP Exchanges, in time priority between such interest.

With all three algorithms, the system would make an exception for non-directed orders entered by a market maker or an ECN ("Nasdaq Quoting Market Participant") when that Nasdaq Quoting Market Participant is also at the inside market. In that case, the system will match off the non-directed order to buy/sell against a Nasdaq Quoting Market Participant's inside quote/order to sell/buy, in lieu of sending it to the participant next in the queue. Additionally, there would be an exception for "Preferred Orders" described below.

b. *Directed Orders.* The NASD intends to retain the changes to the directed order process that were proposed in Amendment No. 7. By way of review, some commenters to the original proposal claimed that the directed order¹⁵ process was an ineffective way

¹⁵ Directed orders are orders that are delivered to a single market participant that is designated by the sender of the order. Directed orders are always delivered for response (accept or decline), as opposed to an automatic execution via Nasdaq system against the receiving market participant's

to access liquidity held in a specific market maker or ECN. This was because, as originally proposed, all directed orders were required to be designated as non-liability or negotiation orders. Originally, the purpose of this requirement was to limit the potential for dual liability that results from having two (non-linked) points for delivering Liability Orders against the same market maker quote.¹⁶ In Amendment No. 7, the NASD proposes to change the directed order process, so that ECNs and market makers can elect to receive Liability Orders against their quote through the directed order process.¹⁷ As proposed in Amendment No. 7, a market maker or ECN could choose to receive against its quote a directed order that is also a Liability Order, or could also choose to accept only non-Liability directed orders. If a Nasdaq Quoting Market Participant or a UTP Exchange chooses to accept Liability Orders, the NASD will append an indicator to the MMID, showing that the Nasdaq Quoting Market Participant or UTP Exchange is available to receive directed Liability Orders.

c. *Preferred Orders.* The NASD proposes to create a new class of order called a "preferred order." The NASD is proposing two possible approaches to preferred orders: Alternative A—Preferred Orders with No Price Restrictions ("Alternative A"); and Alternative B—Preferred Orders with Price Restrictions ("Alternative B"). The NASD requests that commenters express their views as to which approach they believe is most appropriate. Commenters should note that the NASD is not proposing that the SuperMontage include both Alternative A and Alternative B approaches to preference orders. Rather, the NASD proposes that the system, include one of the alternatives—either Alternative A or Alternative B.

1. *General Processing of Preferred Orders Under Both Alternatives.*

quote. Directed orders are processed independent of the non-directed order queue.

¹⁶ As stated previously, the original purpose of requiring directed orders to be non-liability orders was to eliminate the dual liability that currently exists in Nasdaq. As previously proposed, a directed order was required to be designated as: (1) All-or-None and be at least 100 shares greater than the size of the displayed quote/order of the market participant to which the order is directed; or (2) a Minimum Acceptable Quantity order ("MAQ") with an MAQ value of at least 100 shares greater than the displayed amount of the quote/order of the participant to which the order is directed. Because of these conditions, when presented to a market participant's quote a directed order would impose no obligation under the SEC and NASD's firm quote rules.

¹⁷ Both ECNs and market makers would continue to receive liability orders via the non-directed order process.

Preferred orders would be processed as follows for both Alternative A and Alternative B.

A preferred order would be entered into the non-directed order process, and would be considered a liability order. Preferred orders would be processed in the same "queue" as non-directed orders. Additionally, like non-directed orders, a preferred order would be delivered as an order to a market participant that does not participate in the automatic execution functionality of the system, or as an execution against market participants that choose to accept automatic executions. The market participant entering the preferred order must designate by a market participant identification symbol ("MMID") the quoting market participant against which the order is to be executed or delivered. When a preferred order is next to be executed within the non-directed order queue, the SuperMontage would execute against (or deliver an order in an amount up to or equal to) both the displayed quote/order and reserve size of the quoting market participant to which the order is being preferred ("preferred quoting market participant"). Any unexecuted portion could be returned to the entering market participant.

2. *Alternative A—Preferred Orders With No Price Restrictions.* Under Alternative A, there would be no price restriction for preferred orders. That is, when a preferred order is next to be executed within the non-directed order queue, the preferred order would execute (or deliver for execution) at the preferred quoting market participant's price, regardless of whether the quoting market participant is at the best bid/best offer ("BBO"). The execution would occur at the preferred quoting market participant's quoted price. Thus, under Alternative A, preferred orders could be executed at the BBO or outside the BBO.

The purpose of the Alternative A-type preferred order is to maintain a function within the SuperMontage similar to that which currently exists in Nasdaq. That is, today market participants often use the SelectNet service (*i.e.*, order delivery) to preference orders to market makers or ECNs who are quoting at the BBO or away from the BBO. Market participants sometime preference away from the BBO in an attempt to "sweep the street" or access liquidity at or near the inside market. A market maker that is "working" an institutional order may also send a preferred SelectNet message to a market maker or ECN who

is quoting away from the inside. This may occur if the market maker believes the "preferred" market participant has greater size to offer, and thus will result in a more efficient execution for the institutional customer. The NASD wishes to emphasize, however, that even if the SuperMontage ultimately provides the Alternative A type of preference order, as is the case today, market participants would be required to comply with their duty of best execution. Such a function would in no way obviate a market participant's best execution obligations.

3. *Alternative B—Preferred orders with price restrictions.* Under Alternative B, there would be price restrictions for preferred orders. That is, if a preferred order was next to be executed within the non-directed order queue, the preferred order would be executed (or delivered for execution) against the preferred quoting market participant to which the order is being directed *only if the quoting market participant is at the BBO (up to the displayed and reserve size)*. If the quoting market participant to which the order is being directed is not at the BBO when the preferred order is next to be delivered or executed, the preferred order will be returned to the entering participant. Thus, under this approach, preferred orders only would be executed at the BBO, and only if the preferred quoting market participant is quoting at the BBO at the time of order delivery (or execution).

Once again, recognizing that there may be differing views as to whether market participants should be permitted to have preferred orders executed away from the BBO or only at the BBO price, the NASD specifically requests that commenter submit their views on the alternative approaches described above.

4. *Comparison of directed orders and preferred orders.* The directed order and preferred order features provide different options for order processing. The directed order process will operate much like SelectNet operates in the current environment. Directed orders will be delivered to a single market participant that is designated by MMID by the sender of the order. Directed orders are always delivered for response (*e.g.*, accept or decline), as opposed to an automatic execution *via* the Nasdaq system against the receiving market participant's quote. Directed orders will not decrement a quote. As noted above, preferred orders would function almost exactly like non-directed orders, in that they would be processed in time sequence, would be delivered to a quote/order or would automatically

execute against a quote/order of a market participant, and would decrement the size of a quote/order. Unlike "regular-way" non-directed orders, however, preferred orders would not be processed pursuant to one of the three Order Execution Algorithms described above.

d. *Increased Dissemination of Quotation Information.* In order to bring more transparency to the market and give market participants greater information in making order-routing decisions, the NASD has determined to expand its dissemination of quotation information to the investing public. To accomplish this goal, the NASD would create and make available a new vendor data feed called "NQDS Prime." NQDS Prime would provide, on a real-time basis, all individual attributable quote/order information at the three best price levels displayed in the SuperMontage (*i.e.*, Order Display Facility). By using NQDS Prime, vendors will be able to integrate this expanded quote and order information with SuperMontage data and distribute it in a consolidated format that would eliminate any purported informational advantage accruing to the SuperMontage system from the retention of this information.¹⁸ In the future, should the NASD determine to display more than three dynamically displayed price levels in the SuperMontage, an equal expansion of price level information through NQDS Prime would be provided. With this additional information, market participants would have the choice of using Nasdaq's facility to access liquidity or would be able to use non-Nasdaq systems (such as proprietary links) to access liquidity where it resides. Again, the goal is to give market participants and investors choice and the tools to make efficient and informed trading decisions.

The NASD proposes to make this information available through a dedicated data feed. To recoup the technology costs associated with the provision of expanded individual attributable quote and order information, the NASD would assess a separate, additional vendor data fee for quote and order information away from the inside. (The fee for NQDS Prime data feed would be filed separately with

¹⁸ Nasdaq has determined to take a similar approach to SuperMontage reserve size. SuperMontage's rules regarding reserve size apply equally to market makers and ECNs and the system will execute reserve share amounts based on these objective rules. Nasdaq will not use information about the source and scope of a reserve size quote to influence reserve size execution priority within SuperMontage system, or provide optimized reserve size executions based on information residing solely in SuperMontage.

the Commission for public comment.) On an ongoing basis, the NASD would evaluate the demand for away-from-the-inside market data and reserve the right (after consultation with the Commission) to cease the distribution of such information if such distribution does not generate sufficient revenue to cover the cost of assembling and distributing the NQDS Prime product. If the costs of NQDS Prime are covered, the NASD commits to continue to provide the product regardless of the total number of subscribers.

e. *Identity of Parties Entering Orders.* The NASD is committed to assisting market participants in their efforts to manage operational and credit risk that they perceive as potentially arising from their participation in the SuperMontage. In that vein, the NASD wishes to clarify that the SuperMontage would preserve the ability of recipients of orders to determine the identity of the sender of such orders. The NASD would affix the MMID of the sender, to all delivered directed orders (both liability and non-liability), non-directed orders, and preferenced orders. Identification of these orders would allow market participants to decline to trade with participants that are genuinely perceived to pose general credit risks (consistent with SEC guidance and interpretation of its firm quote rule and this issue).

As with Nasdaq's current automatic execution system (SOES), the SuperMontage would generate an immediate execution report, for preferenced or non-directed Orders, that identifies the parties to the trade. Such a report would be generated if a non-directed order was executed against an attributable order or a non-attributable order (*i.e.*, orders that are aggregated under the SIZE MMID).

f. *Preservation of Time Priority for Size Increases to Quotes/Orders.* The NASD also proposes to modify the SuperMontage to protect the time priority of a market participant that changes its displayed trading interest by increasing its displayed size. As currently proposed, if a market participant chooses to give Nasdaq a quote instead of order detail, the market participant would lose time priority (*i.e.*, a new time stamp would be established) when the market participant adds size to its quote. (A decrease in size would not result in change in time priority.) For example, assume a Nasdaq Quoting Market Participant is displaying 5,000 shares at the best price and is first in time as between two other market participants at the same price. If the Nasdaq Quoting Market Participant subsequently

receives a second customer limit order for an additional 2,000 shares, and updates its quote to reflect the additional shares, the participant would lose its original time priority. Such an outcome has the unintended consequence of disadvantaging market participants that update their quotes to display additional size to the market. This outcome is inconsistent with one of the important goals of the SuperMontage—encouraging market participants to display greater sized quotes.

The NASD proposes to amend the SuperMontage to ensure that a market participant will not lose time priority if it updates its displayed trading interest to show greater size. This change in priority rules would apply equally to market makers and ECNs. As proposed, quote entries would receive a time stamp from the system which would be used in determining their ranking in the execution algorithm relative to other quotes/orders at that price level. If a size increment is received for an existing quote at a given price, the system will maintain the original time stamp for the original quantity and separately assign a separate timestamp for the augmentation, thus protecting the time priority of the originally-entered quantity. Additional size increments will be treated similarly. Thus a single quote at a single price level could be tracked in individually-prioritized components corresponding to the original quantity entered at that price plus size increments sent separately. Subsequent decreases in size will be deducted from individually-stamped components in reverse time priority (*i.e.*, the last entered size component will be exhausted first). Once a market participant's displayed size is diminished to zero, however, the market participant no longer retains time priority, even though it may be using the Quote Refresh function to automatically refresh its displayed size.

g. *Order Delivery and Responsiveness Time Frames.* Some market participants have objected to the proposal to retrieve a delivered non-directed order and zero out an ECN's quote if an ECN does not respond (in any manner) within 7 seconds to orders delivered to them by the system. Some commenters asserted that this standard was too short. They also claimed that this approach did not distinguish between system performances of Nasdaq versus an ECN's internal systems, and thus could result in an ECN's quote being improperly zeroed out for system issues outside of the ECN's control.

In response to these concerns, the NASD proposes to alter its approach to

monitoring ECN responsiveness. First, the NASD will amend its SuperMontage rules to establish a 30 second (as opposed to seven seconds) maximum time period for an ECN to respond to any given order. That is, if an ECN fails to respond within 30 seconds of the time a particular order is dispatched from the Nasdaq system to the ECN, Nasdaq will "zero out" the affected side of the unresponsive ECN's quote until the ECN transmits a revised attributable quote/order.

Second, the NASD proposes to establish a shorter uniform turn-around time for a maximum of five seconds. The purpose of this change is to establish a general standard (as opposed to an order-by-order standard) that measures whether an ECN is providing an automated response in a time period that ensures market quality. Thus, the NASD proposes to monitor an ECN's order turnaround time based on information received from the ECN's Nasdaq Service Delivery Platform ("SDP"). (Each subscriber to the Nasdaq Workstation II has an SDP that connects to the Nasdaq Enterprise Wide Network II via a T1 line. SDPs exist at the very outer edge of Nasdaq's network and link directly to the systems of ECNs and other market participants. Orders cannot reach the SDP until they have traveled the full length of Nasdaq's network and are also the point at which an ECN's order response first returns to the Nasdaq system.) Nasdaq will use SDPs linked to ECNs to assign a time-stamp for when an order is delivered to the ECN. Nasdaq will also capture the time-stamp via the SDP of when the ECN sends a response (*e.g.*, accept, decline, or partially execute) to the delivered order. Nasdaq will then calculate and monitor, on a real-time basis, the difference between the two time-stamps and determine whether the ECN is meeting the 5-second maximum order-response standard. On an ongoing basis, Nasdaq will monitor ECN response times and provide individual ECNs their own order responsiveness time statistics. (This information will not be made public.)

In the event that an ECN regularly fails to meet the five-second response time over a period of orders, Nasdaq will place that ECN's quote in a closed-quote state. The NASD believes that this measure is necessary in order to maintain a fair and orderly market and to ensure prompt, reliable, and non-discriminatory access to the best prices in its market. The closed-quote state will be lifted when the ECN can certify that it can meet the five-second response time requirement.

By measuring SDP time, this approach measures an ECN's responsiveness based on the performance of systems it controls, and in effect factors out Nasdaq system time. The NASD believes that this new approach to measuring and evaluating ECN performance responds to ECN desires that their systems be judged individually and that their quotes not be inappropriately or prematurely precluded from receiving orders through the SuperMontage. At the same time, the proposal provides Nasdaq with a uniform, electronic method to ensure that investor orders are not repeatedly sent to market participants that cannot timely process them.

h. *Unexecuted Marketable Limit Order Processing.* Under the current SuperMontage Proposal, marketable limit orders entered into the system that become unmarketable prior to execution are held in queue within the SuperMontage for a period of 90 seconds. The purpose of this feature of the proposal was to provide an additional opportunity for an execution to take place should another market participant subsequently enter a quote that would allow the limit order to execute. In response to concerns about the uncertainty that the retention of such orders may engender, the NASD proposes to modify the SuperMontage so that all marketable limit orders entered by order-entry firms shall be designated as "immediate or cancel" orders. Accordingly, if a marketable limit order becomes non-marketable after entry into the system, Nasdaq will return the order (or the unexecuted portion thereof) to the entering party.

i. *UTP Exchanges.* The NASD also proposes certain clarifying amendments to the proposal regarding UTP Exchanges. At the outset, the rules specifically state that participation in the SuperMontage is completely voluntary. The proposed rules relating to UTP Exchanges would only apply if the UTP Exchange agrees to participate in the system. In addition, the NASD has amended the definition of agency orders. As proposed in Amendment No. 4, a UTP Exchange that chooses to participate in the system could provide Nasdaq with agency orders at multiple price levels. Such orders would receive equal priority in our price/time execution algorithms with orders of market makers and ECNs that do not charge a quote access fee. In Amendment No. 4, the NASD defined "agency order" as an order that is for the benefit of the account of a natural person and that is not for the benefit of a broker and/or dealer. The intent of the latter provision was to distinguish

orders that are for the account of a broker/dealer that is registered with or designated by their UTP Exchange as a specialist, market maker or dealer in the underlying security. The NASD understands that certain market centers receive orders that are for the account of institutions or broker/dealers that are not registered with the UTP Exchange as a specialist, market maker, or dealer in the security. The NASD believes these orders should also be included within the meaning of agency orders, for purposes of the SuperMontage rules. Accordingly, the NASD proposes to define an agency order as "an order that is not for the benefit of a broker/dealer that is, with respect to the UTP Exchange, a registered market maker, dealer or specialist in the security at issue."

2. Statutory Basis

The NASD believes that the proposed amendments are consistent with the provisions of sections 15A(b)(6) of the Act,¹⁹ as well as sections 11A(a)(1)(C) and 11A(a)(1)(D) of the Act.²⁰ Section 15A(b)(6) of the Act²¹ requires that the rules of a registered national securities association be 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; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers. Section 11A(a)(1)(C) of the Act states that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and order markets to assure (1) economically efficient execution of securities transactions; (2) fair competition among brokers and dealers; (3) the availability to brokers, dealers and investors of information with respect to quotations and transactions in securities; (4) the practicability of brokers executing investors' orders in the best market; and (5) an opportunity for investors' orders to be executed without the participation of a dealer.²² Section 11A(a)(1)(D) states that Congress finds that the linking of all markets for qualified securities

through communication and data processing facilities will foster efficiency, enhance competition, increase the information available to brokers, dealers, and investors, facilitate the offsetting of investors' orders, and contribute to best execution of such orders.²³

The NASD believes that the proposed rule changes to the Order Execution Algorithm, the addition of new order types (*i.e.*, preferenced orders and directed orders that impose firm-quote liability), and the NQDS Prime feed are consistent with section 15A(b)(6),²⁴ as they promote just and equitable principles of trade, remove impediments to and perfect the mechanism of a free and open market and a national market system, and protect investors and the public interest. These added features would give market participants greater flexibility in determining how their orders will be executed. The additional information provided by NQDS Prime would give market participants greater information about where liquidity is concentrated, and thus is consistent with section 11A,²⁵ as well as section 15A(b)(6).²⁶ NQDS Prime, combined with the changes to the order execution algorithm and the expansion of order types and preferencing capabilities, will give market participants greater flexibility in making order-routing decisions. In turn, market participants should be better able to manage their customer and proprietary orders, which is consistent with sections 11A(a)(1)(C) and 11A(a)(1)(D).²⁷

The NASD also believes that the changes regarding order-delivery response times for ECNs, and unexecuted marketable limit orders, and the identity of sent (executed) orders, promote just and equitable principles of trade, facilitate transactions in securities, perfect the mechanism of a free and open market and a national market system, and protect investors and the public interest. Thus, the NASD believes these parts of the proposal are consistent with section 15(b)(6) of the Act.²⁸

The NASD believes that the proposed amendments represent a pro-competitive development that offers increased price competition, flexibility, and choice to investors and to market participants that will spur further competition and innovation among

¹⁹ 15 U.S.C. 78o-3(b)(6).

²⁴ 15 U.S.C. 78o-3(b)(6).

²⁵ 15 U.S.C. 78k-1.

²⁶ 15 U.S.C. 78o-3(b)(6).

²⁷ 15 U.S.C. 78k-1(a)(1)(C) and (a)(1)(D).

²⁸ 15 U.S.C. 78o-3(b)(6).

¹⁹ 15 U.S.C. 78o-3(b)(6).

²⁰ 15 U.S.C. 78k-1(a)(1)(C), (a)(1)(D).

²¹ 15 U.S.C. 78o-3(b)(6).

²² 15 U.S.C. 78k-1(a)(1)(C).

market centers and market participants. The NASD believes that the SuperMontage enhances competition by creating a central forum in which buying and selling interest from a broad array of market centers and market participants will be given the opportunity to interact. The resulting enhancement in price discovery and competition, together with the increase in transparency, are competitive goals espoused by section 11A(a)(1)(C) of the Act.²⁹ In addition, by bringing together quotes and orders from diverse sources, the SuperMontage furthers the development of the national market system and is consistent with section 11A(a)(1)(D) of the Act.³⁰

The NASD also believes that the SuperMontage should promote competition by increasing the investor's choices on how to interact with the market. These choices occur at several levels: from whether to submit preferenced, directed, or non-directed orders, to choosing any of three algorithms for the execution of non-directed orders. The ability to choose between the alternative algorithms for automatic execution of non-directed orders should allow investors and market participants to elect how to interact with Nasdaq and participating market centers based on criteria that is important to the system's order-entry participant. Giving the investor the choice of selecting his or her criteria for interaction with the market represents not only a significant means of investor protection, but also is consistent with the goal of section 11A(a)(1)(C)(ii) of the Act to ensure fair competition.³¹

Choice and flexibility in the SuperMontage also characterize Nasdaq's interaction with market participants. Although participation in the SuperMontage should benefit a market participant in various ways such as enabling market participants to satisfy their obligations under Exchange Act Rules 11Ac1-1 and 11Ac1-4³² ("Order Handling Rules") in a simple and efficient manner, participation in the SuperMontage is entirely voluntary. A market participant such as an ECN may elect not to participate at all, and could choose to satisfy its obligations under the Order Handling Rules through a number of other means, including by sending its best bid and offer to other market centers, such as the Chicago Stock Exchange or the Cincinnati Stock Exchange, and in the future, the Pacific Exchange as well as others. Indeed, it is

completely voluntary as to whether a UTP Exchange wishes to participate in the SuperMontage.

If a market maker or ECN elects to participate in the SuperMontage, it will continue to have the option of limiting its participation to only satisfy its duties under the Order Handling Rules. Thus, for example, an ECN or market maker may elect only to send its best bid and offer to the SuperMontage, and withhold the remainder of its order book from display on the SuperMontage.

The NASD believes that the voluntariness of participation in the SuperMontage means that competing market centers and market participants will retain the ability to develop alternative means of establishing links between market centers. Thus, the market for creating a "market for market centers," like the SuperMontage, remains fully contestable. Consequently, the SuperMontage not only preserves, but furthers the incentives for Nasdaq's competitors to undertake technological and structural innovation.

Some commenters have argued that the SuperMontage discriminates unfairly against UTP Exchanges because the algorithms governing the execution of non-directed orders place principal quotes from UTP Exchanges at the end of the execution priority even if they enjoy time priority compared to similarly priced quotes from market makers and ECNs. The NASD believes that this ordering is consistent with the requirements of the Act and with the Commission's past approach to this issue. First, the non-attributable agency interest of UTP Exchanges receives the same priority enjoyed in all three algorithms by similarly priced quotes from market makers and ECNs. Thus, only principal quotes from UTP Exchanges are placed at the end of the execution queue.

Second, the NASD believes that the SuperMontage's treatment of principal interest from UTP Exchanges is consistent with the fair competition requirement of Section 11A(1)(a)(C)(ii) of the Act.³³ In this regard, the NASD believes that it would be inappropriate and inconsistent with the fair competition mandate of the Act for Nasdaq to provide UTP Exchange specialists with the ability to enjoy parity with Nasdaq Quoting Market Participants in the SuperMontage when UTP Exchanges generally require a sweep of their own floor before orders may access the quotes of a competing market center. Even so, the NASD has stated that it is willing to provide

automated executions against its market (*i.e.*, access that is equivalent to that which is offered to NASD members) if the relevant exchange is willing to provide automated execution against its quotes. In the same vein, if an exchange is willing to provide order delivery to its quotes, the NASD will provide order delivery against Nasdaq quotes. The NASD believes its willingness to provide such equivalent and reciprocal access is unprecedented, and should foster competition and greater market efficiency, in furtherance of the goals of the Act.

Some commenters have also questioned the SuperMontage's pro-competitiveness by suggesting that its Order Execution Algorithm for non-directed orders discriminates against ECNs that charge non-subscribers fees for accessing their quotes. The NASD maintains that the previously proposed algorithm was not unfairly discriminatory. Nevertheless, as stated above, consistent with the NASD's philosophy of, and commitment to, maintaining and promoting a fair and open structure for all market participants, and consistent with the NASD's efforts to increase investor choice, the proposed amendments offer the pro-competitive solution of offering several different algorithms for the investor to choose from. As described above, one of these algorithms places quotes from access fee-charging ECNs on time priority with quotes from market participants, non-fee-charging ECNs, and the non-attributable interest of UTP Exchanges. Thus, investors now have the opportunity to interact with the SuperMontage based on whether ECN access fees are significant to them. The NASD believes that the availability of order execution alternatives is an important means of furthering both the Act's mandate of investor protection, fair competition, and enabling the achievement of best execution, and of its requirement of assuring fair competition.

(B) Self-Regulatory Organization's Statement on Burden on Competition

The NASD 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.

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

Written comments were neither solicited nor received.

²⁹ 15 U.S.C. 78k-1(a)(1)(C).

³⁰ 15 U.S.C. 78k-1(a)(1)(D).

³¹ 15 U.S.C. 78k-1(a)(1)(C)(ii).

³² See 17 CFR 240.11Ac1-1 and 240.11Ac1-4.

³³ 15 U.S.C. 78k-1(a)(1)(C)(ii).

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

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- A. By order approve such proposed rule change, or
- B. Institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Commission Discussion

The Commission notes that, by separate letter, the NASD has agreed to provide an alternative quotation and transaction reporting facility for NASD members that effect transactions in the over-the-counter market but that choose not to participate in the SuperMontage.³⁴ Specifically, the NASD has committed to provide a quotation reporting facility that meets the Association's statutory obligations under the Act, and to operate a transaction reporting facility pursuant to an effective transaction reporting plan filed in accordance with the Exchange Act Rule 11Aa3-1.³⁵ The facility would be designed to allow NASD members to meet their obligations under the SEC's Order Handling Rules and Regulation ATS as well as any transaction reporting obligations imposed by the NASD rules. This facility would provide an electronic linkage to the Nasdaq marketplace and would be operational contemporaneously with SuperMontage.

V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 8, including whether Amendment No. 8 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. 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 Amendment No. 8 to File No. NASD-99-53 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.³⁶

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 00-29020 Filed 11-14-00; 8:45 am]

BILLING CODE 8010-01-P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43526 File No. SR-PCX-00-35]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 to the Proposed Rule Change by the Pacific Exchange, Inc. Relating to Equity Housekeeping Amendments

November 7, 2000.

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 October 24, 2000, the Pacific Exchange, Inc. ("PCX" or "Exchange"), on behalf of its wholly-owned subsidiary, PCX Equities, Inc. ("PCXE"), filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the PCX. On November 2, 2000, the PCX submitted Amendment No. 1 to the proposed rule change.³ The Commission is publishing this notice to solicit comments on the proposed rule

change and Amendment No. 1 to the proposed rule change from interested persons.

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

The Exchange proposes to make various housekeeping and technical changes to certain previously approved PCX rules by making minor conforming changes to the existing language in order to incorporate those changes into the PCXE rules. The text of the proposed rule change is available at the Office of the Secretary, PCX, and at the Commission.

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

In its filing with the Commission, the Exchange 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. The Exchange 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 Exchange is proposing to make the following changes below to incorporate previously approved changes to the rules of the PCX into the PCXE rules.⁴ Specifically, the Exchange is proposing to apply the PCX rule language to ETP Holders, Equity ASAP Holders, and ETP Firms by incorporating such rule language into the PCXE rules.⁵

a. *PCXE Rule 2—Equity Trading Permits. Mandatory Decimal Price Testing*—The Exchange proposes to add PCXE Rule 2.25, based upon PCX Rule 1.15(b).⁶ Minor conforming changes

³⁶ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Hassan Abedi, Attorney, Regulatory Policy, PCX, to Nancy Sanow, Assistant Director, Division of Market Regulation, Commission, dated November 1, 2000 ("Amendment No. 1"). In Amendment No. 1, the PCX made a correction to Rule 6.3 by adding the word "must" which had inadvertently been left out. The PCX also clarified that the removal of the phrase "or other appropriately designated forms" from Rule 6.3 was not approved by Securities Exchange Act Release No. 41083 (February 22, 1999), 64 FR 10052 (March 1, 1999) (SR-PCX-98-52). The phrase is being removed because Equity Trading Permit ("ETP") Holders, Equity ASAP Holders, and ETP Firms are only required to submit SEC Form X-17A-5.

⁴ The rules of the PCX that governed the equities trading business of the Exchange were amended and renumbered when the PCXE was created. See Securities Exchange Act Release No. 42759 (May 5, 2000), 65 FR 30654 (May 12, 2000). Thus, the PCX rules that govern the equities business are now referred to as PCXE rules.

⁵ Language was changed mainly to refer to "ETP Holders, Equity ASAP Holders, and ETP Firms" (in the PCXE rules) instead of "members or member organizations" (in the PCX rules), and to refer to the "Corporation" (in the PCXE rules) instead of "Exchange" (in the PCX rules).

⁶ See Securities Exchange Act Release No. 42998 (June 30, 2000), 65 FR 42412 (July 10, 2000).

³⁴ Letter from Frank G. Zarb, Chairman and Chief Executive Officer, NASD to Arthur Levitt, Chairman, Commission, dated October 30, 2000.

³⁵ 17 CFR 11Aa3-1.