

in SuperMontage with any quotes/orders entered by that same firm on the other side of the market by attaching an AIQ flag to the quote/order. The AIQ flag is designed to assist market participants in complying with certain rules and regulations of the Employee Retirement Income Security Act ("ERISA") that preclude and/or limit managing broker-dealers of such accounts from trading as principal with orders generated for those accounts. SuperMontage will not cross an AIQ-flagged order with a "Y" value that resides in the system's book, or is entered for immediate execution, with another quote/order from that same market participant. Instead, the system executes against eligible trading interest of other market participants at that same price level. If there is no such interest, SuperMontage allows no execution, does not go the next price level, and rejects back to the entering party the most recently entered of its two interacting quote/orders.

In order to accommodate potential interaction of bid and offer quote/orders of NNMS Order Entry Firms based solely on the execution algorithm selected as contemplated in File No. SR-NASD-2002-173, Nasdaq modified the AIQ flag. In addition to the current AIQ default value of "N" (allow internalization), and the ability to enter, on an order-by-order basis, an AIQ "Y" value (prohibit internalization), a new AIQ value of "I" (allow internalization based solely on execution algorithm) was created.<sup>6</sup> Quotes/Orders designated with an AIQ value of I skip SuperMontage's automatic internalization function and match off against trading interest entered by that same firm on the other side of the market only if such buy and sell interest would naturally meet based on the selected execution algorithm. In short, the AIQ I value neither forces nor prohibits internalization, and on March 17, 2003, will become the default value for NNMS Order Entry Firms.<sup>7</sup>

The following example illustrate how the AIQ I value works:

- MMA enters 1000 share market order to buy with AIQ Y value (prohibit internalization), price/time.

#### Inside Offer

MMB—\$20 × 500  
ECN1—\$20 × 400  
MMA—\$20 × 400

Resulting executions: 500 against MMB; 400 against ECN1; 100 rejected back to MMA because it would cross/internalize.

- MMA enters 1000 share market order to buy with AIQ I value (internalize based only on execution algorithm selected), price/time.

#### Inside Offer

MMB—\$20 × 500  
ECN1—\$20 × 400  
MMA—\$20 × 400

Resulting executions: 500 against MMB; 400 against ECN1; 100 executed against MMA because the interaction of MMA's buy order and its offer quote occurs naturally based on the price/time execution algorithm selected.

This filing seeks to provide this same "natural" internalization option to Nasdaq Quoting Market Participants. Like the other AIQ values available to Nasdaq Quoting Market Participants, use of the AIQ I value would be purely voluntary and could be used on an order-by-order basis. Nasdaq believes that the AIQ I value provides additional flexibility for Nasdaq Quoting Market Participants to manage the interaction of quotes/orders submitted by them to better serve their customers. In addition, the natural quote/order interaction provided by the AIQ I value may also assist market participants in satisfying certain ERISA regulatory exemptions and thus permit them to interact with orders from otherwise restricted accounts since such executions would occur naturally in the SuperMontage system. Finally, Nasdaq notes that use of AIQ I value simply results in Nasdaq Quoting Market Participants having the option to have their orders execute pursuant to well-recognized and widely-used execution algorithms such as price/time and price/size that have already been approved by the Commission for the SuperMontage system.

#### 2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of section 15A(b)(6) of the Act<sup>8</sup> in that the proposal is designed to promote just and equitable principles of trade, foster cooperation and coordination with persons engaged in processing information with respect to and facilitating transactions in securities, as well as removing impediments to and perfect the mechanism of a free and open market, and, in general, to protect investors and the public interest.

<sup>8</sup> 15 U.S.C. 78o-3(b)(6).

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

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

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

Written comments were neither solicited nor received.

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

Because the foregoing proposed rule: (1) Does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) does not become operative for 30 days or such shorter time as the Commission may designate, if consistent with the protection of investors and the public interest, the proposed rule change has become effective pursuant to section 19(b)(3)(A) of the Act,<sup>9</sup> and subparagraph (f)(6) of Rule 19b-4 thereunder.<sup>10</sup> At any time within 60 days of the filing of the proposed rule change, as amended, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

Nasdaq has requested that the Commission waive the 30-day operative delay. The Commission believes that it is consistent with the protection of investors and the public interest to waive the 30-day operative delay.<sup>11</sup> The Commission notes that the proposed AIQ I flag codifies the order interaction contemplated by Nasdaq in File No. SR-NASD-2003-173 for NNMS Order Entry Firms, as well as provides Nasdaq Quoting Market Participants with the same option. Further, the AIQ Y flag codifies the existing function whereby Nasdaq Quoting Market Participants and, now Order Entry Firms, may avoid internalization entirely. The AIQ Y flag exists to assist certain market participants in complying with certain

<sup>9</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>10</sup> 17 CFR 240.19b-4(f)(6).

<sup>11</sup> For purposes of only accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f). As a result of the waiver, the effective and operative date of the filing is March 14, 2003, the date Nasdaq filed Amendment No. 1.

<sup>6</sup> See Nasdaq Head Trader Alert #2003-026 (February 24, 2003).

<sup>7</sup> NNMS Order Entry Firms will continue to be able to use the AIQ Y value on an order-by-order basis, but, in conformity with SR-NASD-2002-173, will not be permitted to use the AIQ N value.