

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

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

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

1. Purpose

On January 31, 2003, the Commission approved File No. SR-NASD-2002-173 on a 90-pilot basis, which allowed OE Firms to enter non-marketable limit orders into Nasdaq's SuperMontage system using SIZE.⁵ This filing seeks to make permanent the ability of OE Firms to enter orders into SuperMontage under essentially the same terms and conditions approved in the pilot program.⁶

Under the pilot, OE Firms are able to voluntarily enter non-marketable limit orders into SuperMontage without an IOC designation and have them be retained for potential execution⁷ through display in SIZE. OE Firms may enter multiple orders (with or without reserve size) at single or multiple price levels, use any available execution algorithm (price/time, price/time-with-fee-consideration, or price/size). Non-marketable limit orders entered by OE Firms are subject to the automatic execution functionality of the system. Orders of OE Firms on opposite sides of the market are not permitted to automatically interact, if at the best price level, like those of Nasdaq Quoting

Market Participants.⁸ If elected by the OE Firm, its quotes/orders on opposite sides of the market will match off against each other only if such interaction would result based on the execution algorithm selected.⁹ Alternatively, OE Firms may elect not to interact with its orders on the opposite side of the market.¹⁰ Quotes/Orders entered by OE Firms that create a locked/crossed market, will be processed like other locking/crossing quotes/orders as set forth in NASD rule 4710(b)(3).

As stated in the filing creating the pilot program, Nasdaq believes that the proposal is an important step in Nasdaq's ongoing process to make its systems more accessible to all NASD member firms while ensuring that market participants who undertake the burdens of continuous liquidity provision are provided benefits commensurate with their activities. Nasdaq believes that most important, however, are the improvements to market quality that can be expected from the proposal's permanent approval. Nasdaq believes that in addition to enhanced liquidity and informational benefits, retention of non-marketable limit orders from OE Firms in SuperMontage, the proposal can be expected to reduce fragmentation of trading interest, thereby improving execution quality and speed and shrinking the costs market participants now incur when searching for trading partners in multiple venues. Finally, to the extent that any previously rejected OE Firm order is retained, Nasdaq believes the proposal will reduce the potential for locked/crossed markets that can occur if such rejected trading interest is subsequently displayed in an unlinked market center without the benefit of SuperMontage processing to eliminate locks or crosses among all quotes and orders residing in the system. Nasdaq notes that the permanent change proposed here was originally suggested as part of the original public comment process on the SuperMontage proposal, and believes its adoption should have the effect of reducing barriers to access to the SuperMontage system.

⁸ Similarly, OE Firms will not be able to use SuperMontage's self-preferencing feature and have buy and sell interest interact on a basis other than a natural interaction based solely on the selected order execution algorithm.

⁹ See Securities Exchange Release Act No. 47554 (March 21, 2003), 68 FR 15024 (March 27, 2003) (Notice of Filing and Immediate Effectiveness of SR-NASD-2003-39).

¹⁰ *Id.* Change made pursuant to March 27, 2003, telephone conversation between Thomas Moran, Office of General Counsel, Nasdaq, and Terri Evans, Assistant Director, Division, Commission.

2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of section 15A of the Act,¹¹ in general and with section 15A(b)(6) of the Act,¹² in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, 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.

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.

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

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. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. 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

⁵ See Securities Exchange Act Release No. 47301 (January 31, 2003), 68 FR 6236 (February 6, 2003). The 90-day pilot commenced on February 10, 2003.

⁶ Prior to the pilot period, OE Firms were required to designate all limit orders they entered into SuperMontage as Immediate-or-Cancel ("IOC"). This designation, while allowing such orders to potentially execute if marketable when they reached the front of the SuperMontage processing queue, also instructed the system to return them to the OE Firm if their price precluded an immediate execution. In short, OE Firms could enter market orders and marketable limit orders, but could not enter non-marketable limit orders and have them retained in the system for potential display and/or execution.

⁷ NNMS Order Entry Firms will be able to designate orders as IOC, "Good-till-Cancelled," or "Day" orders.

¹¹ 15 U.S.C. 78o-3.

¹² 15 U.S.C. 78o-3(b)(6).