

for that security or any other, and to display a second quote in any stocks in which it is properly registered to do so, subject to the conditions described in the rule and this interpretive material.

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

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

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

1. Purpose

An NASD member that registers as a market maker or ECN is permitted to enter one two-sided quotation per security in the Nasdaq Quotation Montage, and is assigned a unique market participant identifier ("MMID") with which to enter such quotations. The NASD 4600 Rule Series governs the character of such quotations and the rights and obligations of members that display quotations in the Nasdaq Quotation Montage via their MMIDs. The NASD Rule 4700 Series sets forth the rights and obligations of members that participate in the Nasdaq National Market Execution System ("SuperMontage"), including the entry of quotes and orders and the display of quotations. Numerous other NASD and Commission rules govern the conduct of members in their use of MMIDs to enter and execute orders and display quotes, including, for example, NASD IM-2110-2 (the "Manning Interpretation"), NASD Rule 6950 (the "Order Audit Trail System"), and NASD Rule 2320 (the "Best Execution" rule).

Nasdaq proposes to amend NASD Rule 4613(a) to permit market makers and ECNs to request the use of a second MMID for displaying Attributable Quotes/Orders in the Nasdaq Quotation Montage. A market maker would be entitled to request the use of a second MMID for displaying Attributable Quotes/Orders in any security in which it is registered and meets the obligations set forth in NASD Rule 4613(a)(1), including the maintenance of a continuous two-sided quotation. An

ECN would be entitled to request the use of a second MMID for displaying Attributable Quotes/Orders in the Nasdaq Quotation Montage for any security in which it meets the obligations set forth in Rule 4623.

Members that are permitted the use of second MMIDs for displaying Attributable Quotes/Orders would be subject to the same rules applicable to the members' first quotation. In other words, market makers that display a second Attributable Quote/Order would be required to comply with all rules applicable to market makers that display a single Attributable Quote/Order, and ECNs would be required to comply with all rules applicable to ECNs in their display of Attributable Quotes/Orders. There would be only two exceptions to that general principle. First, the continuous two-sided quote requirement and excused withdrawal procedures, as well as the procedures described in NASD Rule 4710(b)(2)(B) and (b)(5) would not apply to market makers' use of second MMIDs. Second, a market maker would be permitted to use only one MMID, its Primary MMID, to engage in passive market making or to enter stabilizing bids pursuant to NASD Rules 4614 and 4619. In all other respects, members would have the same rights and obligations in using a second MMID to enter quotes and orders and to display quotations as they do today.

Nasdaq believes that the ability to enter quotes and orders and to display quotations under a second MMID would benefit the Nasdaq market by enabling members to contribute more liquidity to the market, add to the transparency of trading interest, and better serve the needs of investors.³ Members would use the second MMID to route orders and quotes to SuperMontage from different units within their firms, including market making, arbitrage, retail, and institutional trading desks, among others. Within the same firm, these desks serve a variety of functions and investors, often with different needs and goals that are accomplished by differing trading strategies or practices. Members that, in the past, have specialized in a particular investor type or trading practice have expanded and integrated their operations. Nasdaq believes that these members require the ability to participate in Nasdaq trading in new ways.

At the same time, Nasdaq believes that it is essential for it to maintain its regulation of trading on Nasdaq and the

same high level of compliance with NASD and Commission rules that it believes it has achieved to date. Except as noted in the proposed rule, members that use a second MMID would be required to comply with all NASD and Commission rules applicable to their current use of a single MMID. Members would be prohibited from using a second MMID to accomplish indirectly what they are prohibited from doing directly through a single MMID. For example, members would not be permitted to use a second MMID to avoid their Manning obligations under IM-2110-2, best execution obligations under NASD Rule 2320, or their obligations under the Commission Order Handling Rules. Members would be required to continue to comply with the firm quote rule, the OATS rules, and the Commission order routing and execution quality disclosure rules. In addition, Rule 4613(a) specifically prohibits firms from displaying a second Attributable Quote/Order to engage in passive market making or to enter stabilizing bids because this could violate NASD Rules 4614 and 4619 and Commission Regulation M. To the extent that the allocation of second MMIDs were to create regulatory confusion or ambiguity, every inference would be drawn against the use of a second MMID in a manner that would diminish the quality or rigor of the regulation of the Nasdaq market.

Nasdaq represents that it has a technological limitation on the number of displayed, attributable quotations in an individual security, although it has not reached that maximum to date in any security. Therefore, Nasdaq must consider the issuance and display of a second MMID to be a privilege and not a right. Nasdaq has developed the following method for allocating the privilege of receiving and displaying a second MMID in an orderly, predictable, and fair manner on a stock-by-stock basis.

Nasdaq would automatically designate a market maker's first MMID as a Primary MMID and its second MMID as a Secondary MMID. Market makers would be required to use their Primary MMID in accordance with the requirements of NASD Rule 4613(a)(1), as well as all existing requirements for the use of MMIDs in Nasdaq systems. Market makers' use of Secondary MMID's would be subject to the requirements set forth in NASD Rule 4613(a)(2) and (a)(3), including the prohibition on passive market making. However, the two-sided quote requirement, and the excused withdrawal procedures under NASD Rule 4619, and 4710(b)(2)(B) and (b)(5)

³ Nasdaq will assess no fees for the issuance or use of a second MMID, other than the SEC-approved transaction fees set forth in NASD Rule 7010.