

Montage, and is assigned a unique 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).

Effective July 1, 2003, Nasdaq amended NASD Rule 4613(a) for a two-month pilot period to permit market makers and ECNs to request the use of a second MMID for displaying Attributable Quotes/Orders in the Nasdaq Quotation Montage (the "Pilot").<sup>5</sup> Under the Pilot, a market maker may 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. The Pilot also provides that an ECN may 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 NASD Rule 4623.

Through this rule filing, Nasdaq is proposing to extend the Pilot retroactively to September 1, 2003, and prospectively to March 1, 2004. Since the Pilot began, Nasdaq has granted two market makers' applications for second MMIDs for displaying additional Attributable Quotes/Orders. As of the date of this filing, Nasdaq represents that neither market maker has begun displaying additional Attributable Quotes/Orders under the Pilot. In addition, three ECNs are authorized to use second MMIDs for displaying additional Attributable Quotes/Orders in SuperMontage. Nasdaq represents that those ECNs were authorized to use second MMIDs prior to the launch of the Pilot. However, Nasdaq believes that their continued use of the second MMIDs is subsumed within the later-

filed Pilot. According to Nasdaq, two of those three ECNs are currently using second MMIDs for displaying additional Attributable Quotes/Orders in SuperMontage.

Nasdaq believes the Pilot, though not yet widely used by NASD members, will prove to be an important step in the evolution of its marketplace. Nasdaq represents that trading of Nasdaq securities has changed rapidly and dramatically due to increasingly sophisticated routing and linkage systems that are available to public investors, institutions, broker/dealers and vendors. Nasdaq believes that the ability to enter quotes and orders and to display quotations under a second MMID would help it keep pace with recent changes and allow it to offer functionality that market participants already find elsewhere today. Nasdaq believes that the Pilot should also improve the quality of executions within Nasdaq by enabling members to contribute more liquidity to the market and add to the transparency of trading interest. Due to the surveillance procedures described below, Nasdaq believes that the Pilot should also improve the regulation of trading in Nasdaq securities to the extent members consolidate more of their trading activity in Nasdaq.

Nasdaq believes that it is essential to maintain its regulation of trading on Nasdaq at 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 NASD IM-2110-2, best execution obligations under NASD Rule 2320, or their obligations under the Commission's 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, NASD 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 Regulation M under the Act. 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, in conjunction with NASD, has developed procedures to maintain a high level of surveillance and member compliance with its rules with respect to members' use of both Primary and Secondary MMIDs to display quotations in Nasdaq systems. Nasdaq and NASD have implemented a review process to ensure that firms utilizing second MMIDs under the Pilot do so in accordance with the terms under which use of the second MMID was granted.

Further, Nasdaq represents that new, fully automated surveillance technology has been developed to enable NASD systems to analyze trading and generate alerts at the firm level (*i.e.*, aggregating activity across all MMIDs for a firm into one primary MMID) or the individual MMID level (*i.e.*, treating each MMID separately), depending on the particular surveillance requirements. Nasdaq believes that the use of firm-level information is essential to detecting market participants that may exceed certain surveillance thresholds at the firm level, but would otherwise go undetected at the individual MMID level. Further, Nasdaq believes that the ability to aggregate data and analyze data at the firm level is critical to identifying instances where a firm is using different MMIDs to engage in conduct such as marking-the-close and trading ahead, among other things.<sup>6</sup> Conversely, Nasdaq believes that the use of specific MMID information is critical for the surveillance of individual quotes, trades and orders for compliance with firm quote obligations, among other things.

If it were to be determined that a Secondary MMID issued under the Pilot was being used improperly, Nasdaq would withdraw its grant of the Secondary MMID for all purposes for all securities. In addition, if a market maker or ECN were to no longer fulfill the conditions appurtenant to its Primary MMID (*e.g.*, by being placed into an unexcused withdrawal), it would not be permitted to use the Secondary MMID for any purpose in that security.

## 2. Statutory Basis

Nasdaq believes that the proposed rule change, as amended, is consistent with the Act, including section 15A(b)(6) of the Act,<sup>7</sup> which requires,

<sup>5</sup> For a more detailed explanation of the Pilot, see Securities Exchange Act Release No. 47954 (May 30, 2003), 68 FR 34017 (June 6, 2003) (File No. SR-NASD-2003-87).

<sup>6</sup> Nasdaq represents that it has had no occasion to withdraw the grant of a Secondary MMID due to improper usage under the Pilot.

<sup>7</sup> 15 U.S.C. 78o-3(b)(6).