

NASD members participate in the ITS, an electronic linkage between markets that trade exchange listed securities. In addition, the NASD adopted the NASD Rule 5200 and 6300 Series to ensure that NASD members comply with the obligations imposed by the CT, CQ, and ITS Plans.

Nasdaq proposes no changes to the obligations imposed by the Plans or by the NASD Rule 5200 and 6300 Series. Thus, for example, members must continue to comply with the trade through restrictions in NASD Rule 5262, the locked and crossed markets restrictions in NASD Rule 5263, the block trade requirements in NASD Rule 5264, and the Pre-Opening Application procedures set forth in NASD Rules 5240 and 5250. Members that wish to make markets in ITS Securities must continue to register as ITS/CAES and CQS Market Makers pursuant to NASD Rules 5220 and NASD Rule 6320 and comply with the obligations imposed under NASD Rule 6330.³ They must also continue to clear and settle trades under NASD Rule 5261 and properly report transactions pursuant to the NASD Rule 6400 Series.

To ensure that SuperMontage will enable NASD members trading ITS Securities to continue to comply with applicable NASD and Commission rules, Nasdaq is proposing certain modifications to the existing SuperMontage functionality. These modifications apply to ITS Securities only; they do not affect the trading of Nasdaq-listed securities:

1. Define two participant types: ITS/CAES market makers and order entry firms.
2. Enable ITS/CAES market makers to participate in the Pre-Opening Application in accordance with NASD Rules 5240 and 5250.
3. Enable ITS/CAES market makers to comply with the locked/crossed obligations imposed by NASD Rule 5263.
4. Enable ITS/CAES market makers to comply with the trade through and block trade obligations imposed by NASD Rules 5262 and 5264.
5. Disable Directed, Pegged and End of Day Orders, modify the Discretionary Order, and add four order types to facilitate ITS trading.

³ The NASD Rules will continue to refer to CAES and to ITS/CAES Market Makers in order to maintain consistency with the language of the ITS Plan. To accomplish the name change from CAES to NNMS, Proposed NASD Rule 5210(i) incorporates the ITS Plan definition of CAES and then provides that CAES functionality will now be provided by SuperMontage. In addition, Proposed NASD Rule 5220(c) requires ITS/CAES Market Makers to participate in the NNMS.

6. Remove the Auto-Quote Refresh functionality, modify the decrementation process, and apply the excused withdrawal provisions of NASD Rule 6350, rather than NASD Rule 4619.

7. Prohibit SuperMontage from executing trades in violation of Rule 10a-1 of the Act⁴ or of the obvious error provisions of the ITS Plan.

8. Modify the system to comply with the round lot requirements of the ITS Plan.

9. Modify the adjustment of open buy and sell orders in ITS Securities to conform closely to the practice of the listing exchange.

Set forth below is a description of the proposed modifications.

1. Define Participant Types

NASD members will trade ITS Securities in two ways: as ITS/CAES Market Makers or as NNMS Order Entry Firms.⁵ Proposed NASD Rule 4701(pp) defines ITS/CAES Market Makers by incorporating the definition already contained in NASD Rule 5210(e), which includes both market makers and electronic communications networks ("ECNs"). The definition distinguishes ITS/CAES Market Makers, which make markets in ITS Securities from NNMS Market Makers, which make markets in Nasdaq securities.⁶ ITS/CAES Market Makers will be permitted to choose between the automatic execution and the order delivery functionality of the NNMS system, unlike NNMS Market Makers, which are required to accept automatic executions. Nasdaq believes that this will permit ITS/CAES Market Makers to better manage their interaction with ITS Exchanges either through the NNMS or through their direct connections to those exchanges' systems.

NASD members may also trade ITS Securities through the NNMS as Order Entry Firms, using the same registration process as NNMS Order Entry Firms in Nasdaq securities. Nasdaq is proposing simply to modify the existing definition of NNMS Order Entry Firm, contained in NASD Rule 4710(w), to include both Nasdaq and ITS Securities. Therefore, references to NNMS Order Entry Firms throughout the 4700 Series should be understood to include Order Entry

⁴ 17 CFR 240.10a-1.

⁵ NASD Rule 4710(qq) defines ITS Exchanges as national securities exchanges that participate in the ITS system as defined in NASD Rule 5210(a). ITS Exchanges are not eligible to participate in the NNMS but are defined because the system will send ITS Commitments to and receive them from ITS Exchanges.

⁶ Nasdaq reinforces this distinction by modifying the definition of NNMS Market Maker. See Proposed NASD Rule 4710(u).

Firms participating in either Nasdaq or ITS Securities unless otherwise indicated.⁷

Nasdaq's proposal is dominated by one simple difference between NASD members that trade ITS Securities as ITS/CAES Market Makers and those that trade as NNMS Order Entry Firms: ITS/CAES Market Makers can participate in ITS and NNMS Order Entry Firms cannot. Nasdaq has systematically eliminated any possibility that order entry firms would interact with ITS, by eliminating order entry firms' ability to place liquidity on the SuperMontage book,⁸ to precluding their participation in the Pre-Opening Application, to preventing order entry firms from trading through or locking/crossing the quotations of ITS Exchanges. As a result of Nasdaq's tailoring, Nasdaq is proposing no changes to the NASD rules that implement the ITS Plan, and ITS Exchanges will experience no impact from Nasdaq's decision to replace CAES with SuperMontage.

2. Pre-Opening Application

The NNMS would be modified to permit ITS/CAES Market Makers to participate in the Pre-Opening Application for ITS Securities that is established in the ITS Plan and incorporated in NASD Rules 5240 and 5250. The NNMS system will receive all Pre-Opening Administrative ("POA") Messages, Second Look Messages ("SLM"), and One-Sided Responses ("OSRs") that the ITS Exchanges issue. The NNMS will also disseminate those messages to ITS/CAES Market Makers. Market makers that opt to participate in the Pre-Opening Application may do so by entering Pre-Opening Responses

⁷ The definitions of ITS/CAES Market Makers and NNMS Order Entry Firms are carried forward into other definitions that establish system entitlements. For example, ITS/CAES Market Makers are included in the definitions of NNMS Participants (NASD Rule 4710(v)), Nasdaq Quoting Market Participants (NASD Rule 4710(y)), and Quoting Market Participant (NASD Rule 4710(cc)). Since ECNs may trade ITS Securities only as ITS/CAES Market Makers or as NNMS Order Entry Firms, they are excluded from the definition of NNMS ECNs (NASD Rule 4710(t)).

⁸ See Proposed NASD Rule 4701(o) ("NNMS Order Entry Firms shall be eligible to enter Non-Attributable orders in ITS Securities only if they are designated as Immediate or Cancel"). The ability to enter Non-Attributable Orders in Nasdaq listed securities for display would enable order entry firms to place liquidity in the Nasdaq book under the anonymous acronym "SIZE" and to gain standing in the execution algorithm. Nasdaq is eliminating this feature in order to fully comply with the ITS Plan, although Nasdaq believes that this functionality is consistent with the Exchange Act and is beneficial to investors and market participants alike. As a further result, NNMS Order Entry Firms will not have quotations disseminated via the proposed IM Prime Data Feed. See Proposed NASD Rule 4707(f).