

("PORs") in response to a POA or SLM. In addition, NNMS will receive and process OSRs from the opening ITS Exchange in accordance with NASD Rules 5240 and 5250. NNMS Order Entry Firms are not eligible to participate in the Pre-Opening Application, and the system will not accept PORs that are entered by an Order Entry Firm.

3. Locked and Crossed Markets Processing

The NNMS would process locked or crossed markets between and among ITS/CAES Market Makers largely as it does for Nasdaq securities. A quote/order that would create a locked or crossed market, if entered into the NNMS during normal market hours, will be processed exactly as locks and crosses in Nasdaq securities are processed under existing NASD Rule 4710(b)(3)(A). Rather than display the quote/order at the locking/crossing price, the system will treat the quote/order as a marketable limit order and enter it into the system as a Non-Directed Order. A locking quote/order will be executed at the locking price against the order next in line for execution, and a crossing quote/order will be executed at the displayed price of the order next in line for execution. Once the lock or cross is cleared, any remaining shares will be displayed in the NNMS, if eligible for display.

A quote/order that would create a locked or crossed market between and among ITS/CAES Market Makers prior to normal market hours will be processed exactly as are Nasdaq securities today, except that the NNMS automated unlocking/uncrossing spin will occur at 9:29:55 a.m. for ITS Securities rather than at 9:29:30 a.m. as it does for Nasdaq listed securities.⁹ Quotes/Orders that would create a locked/crossed market after the unlocking/uncrossing spin occurs will be held in queue until 9:30 a.m. Due to the cumbersome structure of the Pre-Opening Application of the ITS Plan, fewer NASD members participate in the pre-market for ITS Securities than for Nasdaq securities. Therefore, a shorter processing window is appropriate.

Nasdaq would program the NNMS to accommodate different processing for locked or crossed markets involving ITS Exchanges. First, if an Order Entry Firm enters an order that would lock or cross an ITS Exchange, the NNMS will execute the order against all Quotes/Orders currently in the system and reject any remaining portion of the order that would create a locked/crossed

market with an ITS Exchange. If an ITS/CAES Market Maker enters a quote/order that would lock or cross an ITS Exchange, the system will process the quote/order in accordance with its designation and automatically generate and send an ITS Commitment to any ITS Exchange that is locked or crossed.¹⁰

If an ITS Exchange has created a locked/crossed market with Nasdaq, the NNMS will notify any ITS/CAES Market Maker whose market was locked/crossed. If Nasdaq receives an ITS Commitment when a locked/crossed condition is pending, Nasdaq will send the ITS Commitment to the ITS/CAES Market Maker(s) at the pending inside price.

4. ITS Trade Through Rule

Nasdaq would modify the NNMS processing to enable ITS/CAES Market Makers to comply with their trade through obligations under NASD Rules 5262 and 5264. The NNMS would reject any order of an NNMS Order Entry Firm that, if executed, would trade through an ITS Exchange. If Nasdaq receives an administrative complaint from an ITS Exchange in response to a potential trade through, Nasdaq will send that complaint to the ITS/CAES Market Maker responsible for the potential trade through, as it does today.¹¹ ITS/CAES Market Makers will respond to administrative complaints by entering into the NNMS a preferred order to the complaining ITS Participant. The NNMS will then generate and send a properly formatted ITS Commitment to the appropriate ITS Exchange.

The NNMS would also monitor for trade-throughs by ITS Exchanges as called for by the ITS Plan and NASD Rules 5262 and 5264. If the system detects a trade through by an ITS Exchange, it will notify the ITS/CAES Market Makers that was traded through.¹² ITS/CAES Market Makers may elect to send administrative complaints on their own behalf. If an inbound ITS Commitment is received, the NNMS will automatically send a preferred Order at the price of the ITS

Commitment to the Nasdaq Quoting Market Participant(s) at that price level, as Nasdaq does today.¹³

5. Modify Available Order Types

Nasdaq is proposing to disable Directed, Pegged and End of Day Orders, modify Discretionary Orders, and add new order types to accommodate the characteristics unique to ITS Securities. Nasdaq, in consultation with current ITS participants, has determined not to offer Directed, Pegged and End of Day Orders for ITS Securities.¹⁴ The processing of orders in ITS Securities is more complex than for Nasdaq securities due to both the presence of ITS and the ability for ITS/CAES Market Makers to accept order delivery rather than automatic executions. The possibility of receiving Directed Orders, in addition to Non-Directed and Preferred Orders and ITS Commitments, seems needlessly complicated. Nasdaq decided not to offer Pegged Orders at this time to hasten its development efforts, and it may file a separate proposal to add that functionality at a later date.

Nasdaq is proposing to modify the characteristics of a Discretionary Order for ITS Securities.¹⁵ Like the current Discretionary Order for Nasdaq Securities, it will have both a displayed bid or offer price, as well as a non-displayed discretionary price range in which the participant is also willing to buy or sell, if necessary. Rather than being fixed or pegged to the Nasdaq best bid and offer, the modified order type must be fixed. Nasdaq will systematically prohibit Discretionary Orders in ITS Securities from creating a quote that locks or crosses the national best bid and offer and from executing at a price that trades through the quotation of an ITS Exchange unless it is designated as a Sweep Order.

Nasdaq is also proposing to create a Fill or Return Order for ITS Securities.¹⁶ Fill or Return Orders will be delivered to or executed by NNMS Participants in ITS Securities through multiple price levels without delivering the order to an ITS Exchange. Unlike the Auto-Ex Order for Nasdaq securities, the Fill or Return Order will execute against ECNs that are

¹⁰ See Proposed NASD Rule 4708(a)(3).

¹¹ See Proposed NASD Rule 4708(a)(2).

¹² Due to technology latencies, rapid quote updates, and a variety of other factors, not all apparent trade throughs violate the ITS Plan. To avoid needless false positives, Nasdaq will program the system, as CAES is programmed today, to provide a trade through "grace period" before issuing an administrative complaint. The system will not detect a trade through unless a particular Nasdaq quote has been in place for the duration of the grace period. The current grace period ranges between five and 17 seconds, depending upon, among others, the level of automation at a particular exchange.

¹³ The ITS Operating Committee has discussed a proposal to add a resolution indicator to ITS Commitments that are intended to respond to an administrative complaint. Nasdaq strongly favors that proposal because it will decrease the difficulty and expense of determining the proper recipient of an inbound ITS Commitment. Nasdaq urges the ITS Operating Committee and the Commission to move quickly to implement that proposal.

¹⁴ See Proposed NASD Rule 4710(f), (j), and (mm).

¹⁵ See Proposed NASD Rule 4710(nn)(2).

¹⁶ See Proposed NASD Rule 4710(ll).

⁹ See Proposed NASD Rule 4710(b)(3)(c).