

side of the market. As a result, in circumstances where the bid/ask spread is greater than \$0.01, the entry of a reverse pegged order would establish a new inside price. A pegged order may not be pegged to prices away from the inside market. Like any other order whose price is changed, a pegged order would be given a new time-priority stamp whenever a change to the inside bid/offer results in an adjustment of the price of a pegged order.

Users may voluntarily select a price execution cap beyond which a pegged order would not be executed. Once a price cap is reached, the pegged/reverse pegged order would be permanently converted to an unpegged limit order at the cap price and would be retained by the system for display and potential execution solely at that price or better; the price of a pegged order that is converted into an unpegged limit order would not thereafter be adjusted, even if the inside bid/offer is later in the range where pegging had previously been occurring. If no execution cap price amount is selected, SuperMontage would continue to adjust the price of the pegged order to follow the inside bid or offer to which it is pegged.

Pegged orders may only be entered as DAY orders. Pegged orders may be entered (but not displayed or executed) prior to market open. Because a pegged order reflects a NNMS participant's willingness to provide liquidity, pegged orders entered before market open would be added to the book and become available for interaction with other orders at 9:30 a.m. The price of pegged orders would be established at 9:30 a.m., based on the inside market at the open. Pegged orders may not be preferenced or directed to another market participant.

A regular pegged order may not itself establish the inside bid or offer. Therefore, if all non-pegged displayable interest at the inside is exhausted, the new inside would be established at the next best price level where displayable non-pegged quotes/orders exist, and the price of pegged orders would be adjusted accordingly. If there are no other market participants on the same side of the market, a regular pegged order would be cancelled and sent back to the entering party.

Because the price of a reverse pegged order is based on changes on the opposite side of the market (e.g., a reverse pegged buy order's price is adjusted based on changes in the offer), such an order may remain alone at the inside. If there are no participants on the contra-side of the market, however, a reverse pegged order would be

cancelled and sent back to the entering party.

Because pegged orders would not allow a market participant to maintain a price that is away from the inside market, they are consistent with Nasdaq's "Autoquote Policy" reflected in NASD IM-4613. Pegged orders would allow all market participants to adjust the prices of orders in a manner similar to the practice of computer generated quoting described in NASD IM-4613(c), which is currently permitted on a case-by-case basis. Because of the potential negative impact that the automatic adjustment of quotes/orders can have on system capacity and performance, however, Nasdaq proposes to specifically retain the right to restrict or prohibit the entry of any type of pegged order entirely, or in a particular issue(s), at any time when SuperMontage is operational or available for the entry of such orders. Pegged or reverse pegged orders that are in the system at the time Nasdaq determines not to accept further such orders would continue to be normally adjusted and executed.

2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 15A of the Act,⁷ in general and with Section 15A(b)(6) of the Act,⁸ in particular, in that the proposal is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, 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. Nasdaq believes the proposed rule change would provide market participants with a voluntary tool to use to offer liquidity at the inside market. Nasdaq notes that the Commission has found similar orders offered by at least one other market center to be consistent with the Act.⁹

⁷ 15 U.S.C. 78o-3.

⁸ 15 U.S.C. 78o-3(b)(6).

⁹ See Securities Exchange Act Release No. 47467 (March 7, 2003), 68 FR 12134 (March 13, 2003) (SR-PCX-2002-75). According to Nasdaq, the Pegged Order proposed in this filing is almost identical in function to the Pacific Exchange Equities, Inc. ("PCXE") Pegged Order approved by the Commission.

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

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Act,¹⁰ and subparagraph (f)(6) of Rule 19b-4,¹¹ thereunder because it does not: (i) Significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate. At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change 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 proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of the filing will also be available for inspection and copying at the principal office of the Association.

¹⁰ 15 U.S.C. 78s(b)(3)(A).

¹¹ 17 CFR 240.19b-4(f)(6).