

Additionally, this rule change proposes to delete references to specific reporting authorities for interest rate options in the appropriate Exchange rules. Currently, Interpretation and Policy .01 to CBOE Rule 23.1 identifies the companies that are the official sources for collecting and disseminating the values that underlie an interest rate measure.<sup>4</sup> The Exchange proposes to amend Interpretation and Policy .01 so that specific entities are not enumerated. As such, the Exchange proposes that Interpretation and Policy .01 be changed to reflect that the Exchange may, from time to time, designate a reporting authority to report the values necessary to calculate and disseminate yields for each security or to determine the closing exercise settlement values of expiring interest rate options.

The CBOE believes that this rule change would allow the CBOE to quickly designate a new reporting authority if a situation were to arise in which an approved reporting authority becomes unable to perform the required calculations. The CBOE believes that incidents such as the tragic events of September 11, 2001 or the expansive blackouts of recent weeks illustrate the need for flexibility to take appropriate action in these situations. The Exchange also believes that it may find it operationally beneficial to change a reporting authority for other reasons. The Exchange represents that any reporting authority chosen would need to have demonstrated to the Exchange that it would be operationally capable of performing the required functions. Although the Exchange would have the ability to change the designated reporting authorities for interest rate options under this proposed rule change, the Exchange has represented that it does not intend nor anticipate changing reporting authorities on a regular basis. The Exchange will issue notification of the designation of any new reporting authority for interest rate options in the form of a regulatory circular.

## 2. Statutory Basis

The CBOE believes that the proposed rule change is consistent with Section 6(b) of the Act<sup>5</sup> in general, and is in furtherance of the objectives of Section 6(b)(5) of the Act<sup>6</sup> in particular, in that

<sup>4</sup> Interpretation and Policy .01 to CBOE Rule 23.1 identifies Telerate, Inc. as the designated reporting authority of each interest rate option's "current value" and identifies Gov PX as the designated reporting authority of each interest rate option's "closing exercise settlement value."

<sup>5</sup> 15 U.S.C. 78f(b).

<sup>6</sup> 15 U.S.C. 78f(b)(5).

providing a reliable source for determining the exercise settlement values of interest rate options, including when the reporting authority previously relied upon for this purpose has discontinued reporting such values, will facilitate exercise transactions in these securities and will thereby serve to protect investors and the public interest.

### B. Self-Regulatory Organization's Statement on Burden on Competition

The CBOE does not believe that the proposed rule change will impose any burden on competition 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

No written comments were solicited or received with respect to the proposed rule change.

## III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>7</sup> and Rule 19b-4(f)(6)<sup>8</sup> thereunder, because the proposed rule change: (1) Does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) by its terms, does not become operative for 30 days after the date of filing. The CBOE provided the Commission with written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least 5 business days prior to the filing date.

At any time within 60 days of the filing of such 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.

<sup>7</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>8</sup> 17 CFR 240.19b-4(f)(6).

Comments may also be submitted electronically at the following e-mail address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov). All comment letters should refer to File No. SR-CBOE-2003-48. This file number should be included on the subject line if e-mail is used. To help us process and review comments more efficiently, comments should be sent in hardcopy or by e-mail but not by both methods. 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 such filing will also be available for inspection and copying at the principal office of the CBOE. All submissions should refer to File No. SR-CBOE-2003-48 and should be submitted by December 30, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>9</sup>

**Jill M. Peterson,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-48868; File No. SR-NASD-2003-165]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment Nos. 1, 2, and 3 Thereto by the National Association of Securities Dealers, Inc. To Establish a New "Discretionary" Order in Nasdaq's SuperMontage System

December 3, 2003.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on November 7, 2003, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its subsidiary, the Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been

<sup>9</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

prepared by Nasdaq. Nasdaq filed Amendment Nos. 1, 2, and 3 to the proposal on November 14, 2003,<sup>3</sup> November 21, 2003,<sup>4</sup> and November 28, 2003, respectively.<sup>5</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

Nasdaq proposes to adopt a new order type, the discretionary order ("DO"), in Nasdaq's National Market Execution System ("NNMS" or "SuperMontage"). Subject to Commission approval, Nasdaq intends to implement the proposed rule change shortly after December 8, 2003, and will inform market participants of the exact implementation date via a Head Trader alert on [www.nasdaqtrader.com](http://www.nasdaqtrader.com). The text of the proposed rule change appears below. New text is in italics. Deleted text is in brackets.<sup>6</sup>

\* \* \* \* \*

<sup>3</sup> See letter from John M. Yetter, Associate General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division of Market Regulation ("Division"), Commission, dated November 14, 2003 ("Amendment No. 1"). In Amendment No. 1, Nasdaq clarified that discretionary orders entered by a market maker with an anti-internalization qualifier value of "Y" (*i.e.*, that may not be internalized) would be cancelled if the only available trading interest is a bid/offer from the same market maker entered automatically by the system under NASD Rule 4710(b)(5). In Amendment No. 1, Nasdaq also clarified the order execution priority for discretionary orders resting on the book.

<sup>4</sup> See letter from John M. Yetter, Associate General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division, Commission, dated November 20, 2003 ("Amendment No. 2"). In Amendment No. 2, Nasdaq reiterated its request for accelerated approval of the proposed rule change pursuant to section 19(b)(2) of the Act.

<sup>5</sup> See letter from John M. Yetter, Associate General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division, Commission, dated November 26, 2003 ("Amendment No. 3"). In Amendment No. 3, Nasdaq amended the description of the proposal to, among other things, explain the treatment of discretionary orders at the opening and DAY order only designation. Nasdaq also amended the proposed rule text to clarify the conditions under which a resting discretionary order would execute at a discretionary price and the price priority of discretionary orders, to replace the phrase "order or Quote/Order" with "Non-Directed Order or Quote/Order," and to reflect the Commission's approval of SR-NASD-2003-134. See Securities Exchange Act Release No. 48821 (November 20, 2003) (Order granting approval of SR-NASD-2003-134).

<sup>6</sup> The Commission recently published for notice and public comment proposed rule changes filed by Nasdaq that proposes to modify the rules governing the operation of SuperMontage. See Securities Exchange Act Release Nos. 48501 (September 17, 2003), 68 FR 56358 (September 30, 2003) (Notice of Filing of SR-NASD-2003-128); 48671 (October 21, 2003), 68 FR 61531 (October 28, 2003) (Notice of Filing of SR-NASD-2003-135); 48674 (October 21, 2003), 68 FR 61508 (October 28, 2003) (Notice of

## 4700. NASDAQ NATIONAL MARKET EXECUTION SYSTEM (NNMS)

### 4701. Definitions

Unless stated otherwise, the terms described below shall have the following meaning:

- (a)-(jj) No Change.
- (kk)-(ll) Reserved.
- (mm) No change.
- (nn) *The term "Discretionary" shall mean, for priced limit orders so designated, an order that when entered into NNMS has 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. The displayed price may be fixed or may be pegged to equal the inside quote on the same side of the market. The pegging of the Discretionary Order may be capped in the same manner as that of a Pegged Order. The discretionary price range of a Discretionary Order that is pegged will be adjusted to follow the pegged displayed price.*

\* \* \* \* \*

### 4706. Order Entry Parameters

(a) Non-Directed Orders—  
(1) General. The following requirements shall apply to Non-Directed Orders Entered by NNMS Market Participants:

(A) A Non-Directed Order may enter into the NNMS a Non-Directed Order in order to access the best bid/best offer as displayed in Nasdaq.

(B) A Non-Directed Order must be a market or limit order, must indicate whether it is a buy, short sale, short-sale exempt, or long sale, and may be designated as an "Immediate or Cancel", or as a "Day" or a "Good-till-Cancelled" order. If a priced order designated as "Immediate or Cancel" ("IOC") is not immediately executable, the unexecuted order (or portion thereof) shall be returned to the sender. If a priced order designated as a "Day" order is not immediately executable, the unexecuted order (or portion thereof) shall be retained by NNMS and remain available for potential display/execution until it is cancelled by the entering

Filing of SR-NASD-2003-149); 48675 (October 21, 2003), 68 FR 61528 (October 28, 2003) (Notice of Filing of SR-NASD-2003-143); and 48798 (November 17, 2003) (Notice of Filing and Immediate Effectiveness of SR-NASD-2003-150). The text of the proposed rule change is shown as marked against the text of the SuperMontage rules as currently in effect, and therefore reflects the immediate effectiveness of SR-NASD-2003-150, but does not reflect proposed rule changes that are not yet effective. Nasdaq represents that it will file such amendments to SR-NASD-2003-165 or other pending filings as Commission staff may request to reflect the approval, disapproval, immediate effectiveness, or withdrawal of other filings.

party, or until 4 p.m. Eastern Time on the day such order was submitted, whichever comes first, whereupon it will be returned to the sender. If the order is designated as "Good-till-Cancelled" ("GTC"), the order (or unexecuted portion thereof) will be retained by NNMS and remain available for potential display/execution until cancelled by the entering party, or until 1 year after entry, whichever comes first. Starting at 7:30 a.m., until the 4 p.m. market close, IOC and Day Non-Directed Orders may be entered into NNMS (or previously entered orders cancelled), but such orders entered prior to market open will not become available for execution until 9:30 a.m. Eastern Time. GTC orders may be entered (or previously entered GTC orders cancelled) between the hours 7:30 a.m. to 6:30 p.m. Eastern Time, but such orders entered prior to market open, or GTC orders carried over from previous trading days, will not become available for execution until 9:30 a.m. Eastern Time. Exception: Non-Directed Day (other than Pegged and Discretionary Orders) and GTC orders may be executed prior to market open if required under Rule 4710(b)(3)(B). In addition, an order may be assigned the designations described below.

*An order may be designated as "Discretionary", in which case the order will also automatically be designated as Day. A Discretionary Order may not be designated as a Preferred Order. The order (or unexecuted portion thereof) shall be displayed in the system, if appropriate, using the displayed price selected by the entering party, with the system also retaining a non-displayed discretionary price range within which the entering party is also willing to execute if necessary. If a Discretionary Order is pegged, its displayed price will be adjusted in response to changes in the Nasdaq inside market. Starting at 7:30 a.m., until the 4 p.m. market close, Discretionary Orders may be entered into NNMS (or previously entered orders cancelled), but such orders entered prior to market open will not become available for execution until 9:30 a.m. Eastern Time. Discretionary Orders whose displayed price or discretionary price range does not lock or cross another Quote/Order will be available for execution at 9:30 a.m. All other Discretionary Orders will be added to the time-priority queue described in Rule 4706(a)(1)(F) and (a)(2)(B) and processed by NNMS at market open.*

An order may be designated as "Pegged," in which case the order will also automatically be designated as Day. A Pegged Order may not be designated as a Preferred Order. A Pegged Order

(or unexecuted portion thereof) will be retained by NNMS and its price adjusted in response to changes in the Nasdaq inside market. A Pegged Order (including a Discretionary Order that is pegged) will be cancelled if there is no displayable Quote/Order to which its price can be pegged. Starting at 7:30 a.m., until the 4 p.m. market close, Pegged Orders may be entered into NNMS (or previously entered orders cancelled), but such orders entered prior to market open will not become available for execution until 9:30 a.m. Eastern Time. The initial price of Pegged Orders (including Discretionary Orders that are pegged) entered prior to market open will be established at 9:30 a.m. based on the Nasdaq inside bid or offer at that time. To maintain the capacity and performance of the NNMS, Nasdaq may at any time suspend the entry of Pegged Orders (including Discretionary Orders that are pegged) for all securities or for any security. Pegged Orders that are in the NNMS at the time of such suspension will continue to be available for adjustment and execution.

(C)–(E) No Change.

(F) A NNMS Market Participant may enter a Non-Directed Order that is either a market order or a limit order prior to the market's open. Market orders and limit orders designated as Immediate or Cancel orders and Discretionary Orders whose displayed price or discretionary price range would lock or cross another Quote/Order if they were displayed shall be held in a time-priority queue that will begin to be processed by NNMS at market open. If an Immediate or Cancel limit order is unmarketable at the time it reaches the front of time-priority processing queue, it will be returned to the entering market participant. Limit orders that are not designated as Immediate or Cancel orders shall be retained by NNMS for potential display in conformity with Rule 4707(b) and/or potential execution in conformity with Rule 4710(b)(1)(B).

(2) Entry of Non-Directed Orders by NNMS Order Entry Firms—In addition to the requirements in paragraph (a)(1) of this rule, the following conditions shall apply to Non-Directed Orders entered by NNMS Order-Entry Firms:

(A) All Non-Directed orders shall be designated as Immediate or Cancel, GTC or Day but shall be required to be entered as Non-Attributable if not entered as IOC. NNMS Order Entry Firms may designate orders as "Pegged[,] or "Discretionary," in which case the order will also automatically be designated as Day. For IOC orders, if after entry into the NNMS of a Non-Directed Order that is

marketable, the order (or the unexecuted portion thereof) becomes non-marketable, the system will return the order (or unexecuted portion thereof) to the entering participant.

(B) A Non-Directed Order that is either a market or limit order may be entered prior to the market's open. [Such limit] Limit and market orders designated as Immediate or Cancel and Discretionary Orders whose displayed price or discretionary price range would lock or cross another Quote/Order if they were displayed will be held in a time-priority queue that will begin to be processed at market open. A limit order that is designated as IOC and is not marketable at the time it reaches the front of the time-priority processing queue will be returned to the entering participant.

(b)–(e) No change.

#### 4707. Entry and Display of Quotes/Orders

(a) Entry of Quotes/Orders—Nasdaq Quoting Market Participants may enter Quotes/Orders into the NNMS, and NNMS Order Entry Firms may enter Non-Attributable Quotes/Orders into the NNMS, subject to the following requirements and conditions:

(1) No change.

(2) Upon entry of a Quote/Order into the system, the NNMS shall time-stamp it, which time-stamp shall determine the ranking of the Quote/Order for purposes of processing Non-Directed Orders as described in Rule 4710(b). For each subsequent size increase received for an existing quote at a given price, the system will maintain the original time-stamp for the original quantity of the quote and assign a separate time-stamp to that size increase. When a Pegged Order (including a Discretionary Order that is pegged) is displayed as a Quote/Order, its time-stamp will be updated whenever its price is adjusted.

(3)–(4) No change.

(b)–(e) No change.

#### 4710. Participant Obligations in NNMS

(a) No change.

(b) Non-Directed Orders

(1) No change.

(A) No change.

(B) No change.

(i)–(iii) No change.

(iv) Exceptions.—The following exceptions shall apply to the above execution parameters:

a. If a Nasdaq Quoting Market Participant or NNMS Order Entry Firm enters a Non-Directed Order into the system, before sending such Non-Directed Order to the next Quoting Market Participants in queue, the NNMS will first attempt to match off the order

against the Nasdaq Quoting Market Participant's or NNMS Order Entry Firm's own Quote/Order if the participant is at the best bid/best offer in Nasdaq. Nasdaq Quoting Market Participants and NNMS Order Entry Firms may avoid any attempted automatic system matching permitted by this paragraph through the use of an anti-internalization qualifier (AIQ) quote/order flag containing the following values: "Y" or "I", subject to the following restrictions:

Y—if the Y value is selected, the system will execute the flagged quote/order solely against attributable and non-attributable quotes/orders (displayed and reserve) of Nasdaq Quoting Market Participants and NNMS Order Entry Firms other than the party entering the AIQ "Y" flagged quote/order. If the only available trading interest is that of the same party entered the AIQ "Y" flagged quote/order, the system will not execute at an inferior price level, and will instead return the latest entered of those interacting quote/orders (or unexecuted portions thereof) to the entering party; provided, however, that in the case of a Discretionary Order interacting with a bid/offer entered by the system pursuant to Rule 4710(b)(5), the Discretionary Order (or unexecuted portions thereof) will be returned.

I—if the I value is selected, the system will execute against all available trading interest, including the quote/orders of the NNMS Order Entry Firm or Nasdaq Quoting Market Participant that entered the AIQ "I" flagged order, based exclusively on the execution algorithm selected when entering the AIQ I flagged quote/order.

b.–c. No change.

d. Reserved.

e. If an NNMS Market Participant enters a Discretionary Order, the Discretionary Order shall first be executed against (or delivered in an amount equal to) the Quotes/Orders and Reserve Size of NNMS Market Participants (including displayed Discretionary Orders at their displayed prices) in conformity with this rule and subject to any applicable exceptions. If the full size of the incoming Discretionary Order cannot be executed at its displayed price, the order may also be executed against (or delivered in an amount equal to) the Quotes/Orders and Reserve Size of NNMS Market Participants within the incoming Discretionary Order's discretionary price range (including displayed Discretionary Orders at their displayed prices), in conformity with this rule and subject to any applicable exception. If the full size of the incoming Discretionary Order cannot be executed

in this manner, the order may also be executed by (or receive delivery of) displayed Discretionary Orders with discretionary price ranges that overlap with the incoming Discretionary Order's discretionary price range, in conformity with this rule and subject to any applicable exception. The unexecuted portion of a Discretionary Order will then be retained by NNMS for potential display in conformity with Rule 4707(b).

When a Discretionary Order is displayed as a Quote/Order, Non-Directed Orders or Quotes/Orders entered at the displayed price (including incoming Discretionary Orders with a displayed or discretionary price equal to the displayed Discretionary Order's displayed price) may be executed against (or delivered to) the displayed Discretionary Order, and market orders may be executed against (or delivered to) the displayed Discretionary Order when its displayed price is at the inside. Non-Directed Orders or Quotes/Orders (other than Discretionary Orders) entered at a price within the displayed Discretionary Order's discretionary price range may be executed by (or receive delivery of) the displayed Discretionary Order at the price of the incoming Non-Directed Order or Quote/Order if there are no displayed Quotes/Orders at that price or better. Incoming Discretionary Orders with a discretionary price range that overlaps with the displayed Discretionary Order's discretionary price range may be executed by (or receive delivery of) the displayed Discretionary Order at the overlapping price most favorable to the displayed Discretionary Order. A displayed Discretionary Order that may be executed at a price in its discretionary price range will execute against Non-Directed Orders and Quotes/Orders entered by NNMS Participants in the automatic execution functionality of the NNMS, and will be delivered to Non-Directed Orders and Quotes/Orders entered by NNMS Order-Delivery ECNs.

For purposes of determining execution priority, the price priority of a displayed Discretionary Order will be based on its displayed price when it may be executed at its displayed price. When displayed Discretionary Orders may be executed at prices within their discretionary price ranges, their price priority vis-à-vis one another will be based on their most aggressive discretionary prices, and their price priority vis-à-vis Quotes/Orders that are not Discretionary Orders will be based upon the price at which they are executable.

(C)–(D) No change.

(2)–(8) No change.

(c)–(e) No change.

\* \* \* \* \*

## 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

To provide increased functionality to system users, Nasdaq proposes to adopt a new order type, DO, for use in SuperMontage. A DO would allow market participants to enter an order that has both a displayed bid or offer price and a non-displayed discretionary price range within which the participant is also willing to buy or sell, if necessary. For example, a market participant may enter a DO to buy at \$20.00, with a discretionary price range of \$0.05, thereby indicating that the market participant wishes to buy at \$20.00, but is also willing to pay up to \$20.05, if necessary. If the \$20.00 price matches the best offer (i.e., if the \$20.00 price is marketable), the DO would first execute against Quotes/Orders and reserve size at that price. If the \$20.00 price is not marketable, or if size available at that price is exhausted, the DO would next execute against Quotes/Orders (including DOs at their displayed prices) and reserve size at successively higher prices, up to \$20.05, and then interact with displayed DOs with overlapping discretionary price ranges. If the incoming DO is not filled through this process, it would be displayed on the book at \$20.00 along with other quotes/orders at that price.

DOs on the book would interact with incoming orders in the following manner. Market orders would execute against or be delivered to a DO's displayed price if it is at the inside market, with the DO's discretionary price range not taken into consideration. Incoming limit orders and DOs that are marketable against the best bid/best offer would likewise execute against or be delivered to a DO with a displayed price at the inside market. Incoming

limit orders with prices that fall within the discretionary ranges of DOs may be executed by DOs, with the execution occurring at the price of the incoming order, if there are no displayed Quotes/Orders at that price or better.<sup>7</sup> Similarly, incoming DOs whose discretionary price ranges overlap with the discretionary price ranges of resting DOs would execute at the price most beneficial to the resting order. Thus, if the best bid was \$20.00, and a DO to buy at \$20.00 with discretion up to \$20.02 was on the book, the DO could interact with (i) a market order (at \$20.00), (ii) a marketable limit order or DO (at \$20.00), (iii) a limit order priced at \$20.01 or \$20.02 (at the price of the limit order), or (iv) a DO with a discretionary price of \$20.01 and/or \$20.02, at the lowest overlapping price. For purposes of determining execution priority, the price priority of a displayed DO would be based on its displayed price when it may be executed at its displayed price.<sup>8</sup> When displayed DOs may be executed at prices within their discretionary price ranges, their price priority vis-à-vis one another would be based on their most aggressive discretionary prices, and their price priority vis-à-vis Quotes/Orders that are not DOs will be based upon the price at which they are executable.<sup>9</sup>

If a new quote/order would interact with a resting DO's discretionary price(s), SuperMontage would immediately execute the overlapping portion of the newly-entered quote/order. Thus, if the best bid was \$20.00, the best offer was \$20.08, and a DO to buy at \$20.00 with discretion up to \$20.04 was on the book, a new offer at \$20.03 would be immediately executed against by the resting DO. If the new quote/order is entered by an NNMS Order-Delivery ECN, however, SuperMontage will instead deliver an order to the ECN for its acceptance.<sup>10</sup>

It should be noted that when SuperMontage matches an incoming Non-Directed Order or Quote/Order against a price in the discretionary price range of a DO submitted by an NNMS Order-Delivery ECN residing in the SuperMontage book, the resting DO would: (i) Automatically execute if the incoming order has been entered by an NNMS automatic execution participant, or (ii) be delivered if the incoming order has been entered by an NNMS Order-Delivery ECN. This is the case because the participant entering the incoming order would have no awareness of the

<sup>7</sup> See Amendment No. 3, *supra* note 5.

<sup>8</sup> See Amendment No. 1, *supra* note 3.

<sup>9</sup> See Amendment No. 3, *supra* note 5.

<sup>10</sup> *Id.*

discretionary price range reflected in the resting DO, and would therefore expect its order to be displayed and provide liquidity, rather than to execute. By contrast, the participant entering the resting DO has, by that fact, expressed a willingness to buy (sell) at prices higher (lower) than its displayed price, but not a willingness to make its potential interest at other price levels known to other market participants. Accordingly, Nasdaq believes that it is more in keeping with the parties' expectations, and therefore fairer, to base the determination of whether the interacting orders should be delivered or automatically executed on the status of the party entering the incoming order, rather than the status of the party that originally entered the DO. When an incoming order is matched against a resting DO entered by an Order-Delivery ECN at the displayed price of the resting DO, however, the incoming order would be delivered to the Order-Delivery ECN.

DOs may only be entered as DAY orders (reflecting Nasdaq's expectation that market participants would not generally seek to reflect discretionary trading interest at multiple price points on an inter-day basis). DOs may be entered (but not displayed or executed) prior to market open. Accordingly, DOs entered before market open that do not lock or cross other Quotes/Orders will be available for interaction with other orders at 9:30 a.m. DOs that would lock or cross another Quote/Order if they were displayed will be held in a time-priority queue (along with IOC orders) and processed by the NNMS at 9:30 a.m. Since a market participant entering a DO would prefer the order to execute at its displayed price (but is also willing to accept executions within its discretionary price range), Nasdaq believes it is appropriate to prevent executions of DOs prior to 9:30 a.m., since the comparatively scattered nature of trading before the market open makes it more likely that the DO would execute at a discretionary price. This is particularly the case during the "opening spin" described in NASD Rule 4710(b)(3)(B), where DOs would have a marked tendency to execute at prices away from their displayed price. For example, if a DO to buy at 10 with a discretionary price range of up to 10.05 was processed through the opening spin, and was entered in time after a Quote/Order to sell with a price of 10.02, the DO could execute at 10.05, since Quotes/Orders in the opening spin are executed at the price of the more recent Quote/Order.<sup>11</sup>

DOs may not be preferenced or directed to another market participant. In conformity with NASD Rule 4706(a)(1)(C), the system will not allow a DO to sell short to be executed if its execution would violate the short sale rule. DOs entered by a market maker with an anti-internalization qualifier value of "Y" (i.e., that may not be internalized) will be cancelled if the only available trading interest is a bid/offer entered automatically by the system under NASD Rule 4710(b)(5) after the market maker's quote has been closed.<sup>12</sup>

Market participants may peg the displayed price of a DO in a manner similar to that of a pegged order.<sup>13</sup> Thus, a market participant can elect to enter a pegged-discretionary order that has its displayed price pegged to equal the Nasdaq inside on the same side of the market as the DO. The discretionary price range of the DO would, in turn, move along with the displayed pegged price. As with a regular pegged order, the market participant entering the order can specify a price cap, so that the displayed price of the order will become permanently fixed if the Nasdaq inside equals the price cap. A DO cannot be designated as a reverse pegged order, however, since its discretionary price range would then lock or cross the price to which the order would be pegged. If Nasdaq suspends the entry of pegged orders during a period when they are negatively impacting system capacity and performance, as permitted by NASD Rule 4706(a)(1)(B), the suspension would apply to pegged-discretionary orders as well.

## 2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of section 15A of the Act,<sup>14</sup> in general, and with section 15A(b)(6) of the Act,<sup>15</sup> in particular, in that it is designed 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

<sup>12</sup> *Id.*

<sup>13</sup> See Securities Exchange Act Release No. 48798 (November 17, 2003) (Notice of Filing and Immediate Effectiveness of SR-NASD-2003-150).

<sup>14</sup> 15 U.S.C. 78o-3.

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

express potential trading interest at multiple price levels. Nasdaq notes that the Commission has found a similar order offered by at least one other market center to be consistent with the Act.<sup>16</sup>

## 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, as amended.

## 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

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding, or (ii) as to which the NASD consents, the Commission will:

(A) By order approve such proposed rule change; or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, 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. Comments may also be submitted electronically at the following e-mail address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov). All comment letters should refer to File No. SR-NASD-2003-165. This file number should be included on the subject line if e-mail is used. To help us process and review comments more efficiently, comments should be sent in hardcopy or by e-mail but not by both methods. 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

<sup>16</sup> See Securities Exchange Act Release No. 44983 (October 25, 2001), 66 FR 55225 (November 1, 2001) (SR-PCX-00-25).

<sup>11</sup> *Id.*

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 such filings will also be available for inspection and copying at the principal office of the Association. All submissions should refer to File No. SR-NASD-2003-165 and should be submitted by December 30, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>17</sup>

Jill M. Peterson,

Assistant Secretary.

[FR Doc. 03-30500 Filed 12-8-03; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-48864; File No. SR-NASD-2003-169]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Inc. To Remove Pricing for Tools and Tools Plus Products

December 2, 2003.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4<sup>2</sup> thereunder, notice is hereby given that on November 24, 2003, the National Association of Securities Dealers, Inc. ("NASD"), through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq. Pursuant to section 19(b)(3)(A)(iii) of the Act<sup>3</sup> and Rule 19b-4(f)(3) thereunder,<sup>4</sup> Nasdaq has designated this proposal as one concerned solely with the

administration of the self-regulatory organization, which renders the proposed rule change effective immediately upon filing. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

Nasdaq is proposing to remove pricing for the Tools and Tools Plus products formerly supported by Nasdaq. Nasdaq will implement the proposed rule change immediately.

The text of the proposed rule change is below. Proposed new language is in *italics*; proposed deletions are in [brackets].

\* \* \* \* \*

7000. Charges for Services and Equipment

7050. Other Services

- (a)-(d) No change.
[(e) Software Products]
[(1) The following fees shall be paid by customers of Tools TM:]

Table with 2 columns: Description and Price. Rows include [(A) Fee Charge], [Minimum fee per market participant], [Coverage of each additional block of 25 or fewer stocks], [Each additional office equipped with Tools], and [Aggregate maximum fee per market participant].

[B] Customers who also subscribe to Tools PlusSM services shall receive the following reduction on fees incurred pursuant to subsection (1)(A):]

Table with 2 columns: Description and Discount. Rows include [Number of Tools Plus Terminals], [Five or fewer Tools Plus terminals], [Between six and 15 Tools Plus terminals], and [Greater than 15 Tools Plus terminals].

[(2) The following deposits and fees shall be paid by all customers of Tools Plus:]
(A) Each customer shall pay a deposit at the time it initially subscribes to Tools Plus equal to two times the subscriber's aggregate monthly Terminal Charge (as defined below), calculated based on the number of terminals ordered by the subscriber upon subscribing to Tools Plus (the "Deposit"). The Deposit shall be refunded to the customer upon termination of its subscription to Tools Plus after deducting any outstanding balances owed Nasdaq.
[(B) Terminal Charge]

Table with 2 columns: Description and Price. Rows include [Fee Charge], [Terminal Charge per full functionality terminal equipped with Tools Plus], [(More than 30 terminals if customer signs two-year contract)], [(All other situations)], [Terminal Charge per correspondent/ floor broker terminal equipped with Tools Plus], [Minimum Terminal Charge], and [(C) Fee Charge].

17 17 CFR 200.30-3(a)(12).
15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.
3 15 U.S.C. 78s(b)(3)(A)(iii).

4 17 CFR 240.19b-4(f)(3).