

Market Participants to provide written notice, via facsimile, personal delivery, courier or overnight mail, at least 14 calendar days in advance to ADF Operations before denying direct or indirect electronic access to an NASD member. The 14-day period begins on the first business day that ADF Operations has receipt of the notice. To ensure proper documentation of compliance with this rule, members should maintain evidence of receipt of the notice (*i.e.*, dated facsimile confirmation, receipt from a courier, etc.). ADF Operations will then post this notice on the ADF Web page to ensure that members have adequate time to make other routing or access arrangements, as necessary.

NASD believes that it is important to note, however, that the proposed notification and publication of an ADF Market Participant's intent to deny access will have no bearing on the merits of any claim between the ADF Market Participant and any affected broker-dealers, nor will it insulate the ADF Market Participant from liability for violations of NASD rules or the federal securities laws should it be determined that the denial of access was inappropriate.

## 2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>8</sup> which requires, among other things, that NASD's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The proposed rule change would amend NASD Rule 4300A to require an ADF Market Participant to provide advance written notice to ADF Operations before denying electronic access to its ADF quote, thereby, NASD believes, facilitating market efficiency and reducing potential confusion for market participants.

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

NASD does not believe that the proposed rule change, as amended, 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

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 self-regulatory organization 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. All comment letters should refer to File No. SR-NASD-2004-02. This file number should be included on the subject line if e-mail is used. To help the Commission 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, as amended, that are filed with the Commission, and all written communications relating to the proposed rule change, as amended, 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 NASD.

All submissions should refer to file number SR-NASD-2004-02 and should be submitted by March 16, 2004.

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

**Margaret H. McFarland,**  
*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49265; File No. SR-NASD-2004-019]

### **Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendments No. 1 and 2 Thereto by the National Association of Securities Dealers, Inc. To Clarify the Application of SuperMontage Pricing to Discretionary Orders**

February 17, 2004.

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 February 2, 2004, the National Association of Securities Dealers, Inc. ("NASD"), through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), submitted to 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. On February 6, 2004, Nasdaq submitted Amendment No. 1 to the proposal.<sup>3</sup> On February 10, 2004, Nasdaq filed Amendment No. 2 to the proposal.<sup>4</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

<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.

<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 February 5, 2004 ("Amendment No. 1"). In Amendment No. 1, Nasdaq amended the proposed rule text to clarify that a resting discretionary order that executes within its discretionary price range is deemed to be the liquidity accessor, unless the incoming order against which it executes is designated "immediate-or-cancel," in which case the incoming order is the liquidity accessor. Nasdaq also clarified the manner that it intends to implement discretionary orders.

<sup>4</sup> See letter from John M. Yetter, Associate General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division, Commission, dated February 9, 2004 ("Amendment No. 2"). In Amendment No. 2, Nasdaq made a technical amendment to the proposed rule text.

<sup>8</sup> 15 U.S.C. 78o-3(b)(6).

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

Nasdaq proposes to clarify the application of Nasdaq's pricing schedule for the Nasdaq National Market Execution System ("NNMS" or "SuperMontage") to discretionary

orders. Nasdaq will implement the proposed rule change in conjunction with the introduction of the discretionary order in SuperMontage.<sup>5</sup>

The text of the proposed rule change is below. Proposed new language is in italics.

**Rule 7010. System Services**

(a)–(h) No change.  
(i) Nasdaq National Market Execution System (SuperMontage).

(1) The following charges shall apply to the use of the Nasdaq National Market Execution System (commonly known as SuperMontage) by members:

**ORDER ENTRY**

Non-Directed Orders (excluding Preferred Orders) .....	No charge.
Preferred Orders:	
Preferred Orders that access a Quote/Order of the member that entered the Preferred Order).	No charge.
Other Preferred Orders .....	\$0.02 per order entry.
Directed Orders .....	\$0.10 per order entry.

**ORDER EXECUTION**

Non-Directed or Preferred Order that accesses the Quote/Order of a market participant that does not charge an access fee to market participants accessing its Quotes/Orders through the NNMS:	
Charge to member entering order:	
Average daily shares of liquidity provided through the NNMS by the member during the month:	
400,000 or less .....	\$0.003 per share executed (but no more than \$120 per trade for trades in securities executed at \$1.00 or less per share).
400,001 to 5,000,000 .....	\$0.0027 per share executed (but no more than \$108 per trade for trades in securities executed at \$1.00 or less per share).
5,000,001 or more .....	\$0.0025 per share executed (but no more than \$100 per trade for trades in securities executed at \$1.00 or less per share).
Credit to member providing liquidity .....	\$0.002 per share executed (but no more than \$80 per trade for trades in securities executed at \$1.00 or less per share).
Non-Directed or Preferred Order that accesses the Quote/Order of a market participant that charges an access fee to market participants accessing its Quotes/Orders through the NNMS:	
Charge to member entering order:	
Average daily shares of liquidity provided through the NNMS by the member during the month:	
400,000 or less .....	\$0.001 per share executed (but no more than \$40 per trade for trades in securities executed at \$1.00 or less per share).
400,001 or more .....	\$0.001 per share executed (but no more than \$40 per trade for trades in securities executed at \$1.00 or less per share, and no more than \$10,000 per month).
Directed Order .....	\$0.003 per share executed.
Non-Directed or Preferred Order entered by a member that accesses its own Quote/Order submitted under the same or a different market participant identifier of the member.	No charge.

**ORDER CANCELLATION**

Non-Directed and Preferred Orders .....	No charge.
Directed Orders .....	\$0.10 per order cancelled.

*(2) For purposes of assessing NNMS fees and credits hereunder, (A) a Discretionary Order that executes prior*

*to being displayed as a Quote/Order will always be deemed to be accessing liquidity unless it is executed by (or*

*receives delivery of) a displayed Discretionary Order at a price in the discretionary price range of the*

<sup>5</sup> The discretionary order had previously been scheduled for introduction within three weeks of its date of approval by the Commission. See Securities Exchange Act Release No. 49085 (January 15, 2004), 69 FR 3412 n.8 (January 23, 2004) (SR–NASD–2003–165). As a matter of operational efficiency, however, Nasdaq has determined that it would be preferable to coordinate implementation of the order with the elimination of certain order

execution algorithms proposed in Securities Exchange Act Release No. 48501 (September 17, 2003), 68 FR 56358 (September 30, 2003) (SR–NASD–2003–128). Accordingly, Nasdaq will defer introduction of the discretionary order for a few additional weeks, and will inform market participants of the exact implementation date via a Head Trader Alert on [www.nasdaqtrader.com](http://www.nasdaqtrader.com). If the Commission disapproves SR–NASD–2003–128 or if

approval of SR–NASD–2003–128 is significantly delayed, Nasdaq will introduce the discretionary order separately, and will inform market participants of the exact implementation date via a Head Trader Alert on [www.nasdaqtrader.com](http://www.nasdaqtrader.com). See Amendment No. 2, *supra* note 4.

The Commission notes that it approved File No. NASD–2003–128 on February 11, 2004. See Securities Exchange Act Release No. 49220.

*displayed Discretionary Order, and (B) a Discretionary Order that executes after being displayed as a Quote/Order will always be deemed to be providing liquidity, unless the displayed Discretionary Order executes against (or is delivered to) a Quote/Order or Non-Directed Order that has not been designated "Immediate or Cancel," at a price in its discretionary price range.*

(j)–(u) 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

The Commission recently approved the introduction of the discretionary order as a new order type for use in SuperMontage.<sup>6</sup> As described more fully in Nasdaq's filing to establish the discretionary order,<sup>7</sup> a discretionary order may execute either at its displayed bid or offer price or at non-displayed discretionary price(s) at which the participant is also willing to buy or sell, if necessary. For example, a market participant may enter a discretionary order 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. An incoming discretionary order will attempt to execute at its displayed price and then at successively higher prices, up to its highest discretionary price. If an incoming discretionary order is not filled through interaction with Quotes/Orders on the SuperMontage book, the discretionary order will be posted and available for interaction with incoming orders, either at its displayed price or at discretionary price(s).

Nasdaq's current fee schedule for SuperMontage features a per share charge for the execution of Non-Directed or Preferred Orders that access liquidity provided by Quotes/Orders resting on the SuperMontage book, as well as a per share credit to a member that provides the liquidity for an execution and does not charge an access fee. The purpose of this rule change is to clarify the conditions under which a discretionary order is deemed to access liquidity (and is therefore assessed an execution charge) and the conditions under which it is deemed to provide liquidity (and is therefore eligible for a liquidity provider credit).

An incoming discretionary order that executes against a Quote/Order on the SuperMontage book is always considered the liquidity accessor and is charged accordingly, unless it is executed by (or receives delivery of) a displayed discretionary order at a price in the discretionary price range of the displayed discretionary order. A resting discretionary order that executes at its displayed price is always deemed to be the liquidity provider. A resting discretionary order that executes within its discretionary price range is deemed to be the liquidity accessor, unless the incoming order against which it executes is designated "immediate-or-cancel," in which case the incoming order is the liquidity accessor.

Nasdaq believes that designating the liquidity provider and accessor in this manner will ensure that fees and credits for order executions are assigned in accordance with the reasonable expectations of the parties to transactions involving discretionary orders. Specifically, because discretionary prices are not displayed, market participants entering orders will not be able to base their expectations about whether their orders will execute or be displayed on knowledge about available discretionary prices. Moreover, although a participant entering a discretionary order is willing to trade at discretionary prices if necessary, it is not willing to advertise these prices to the market. Thus, if the best bid of \$20.00 was set by a discretionary order with discretion up to \$20.04 and the best offer was \$20.05, a market participant entering a "Day" limit order to sell at \$20.04 would expect the order to establish a new best offer, but the order would instead be executed by (or receive delivery of) the discretionary order at \$20.04. Under these circumstances, Nasdaq believes that the participant entering the Day limit order should be treated as the liquidity provider, while the participant with the discretionary order should be

treated as the liquidity accessor. This principal would apply if the incoming limit order was itself a discretionary order that was executed by (or received delivery of) a resting discretionary order at its discretionary price, since the participant entering the incoming discretionary would not be aware of the discretionary prices of the resting order.<sup>8</sup> Moreover, since the two interacting discretionary orders would execute at the price most favorable to the resting order, it is reasonable to treat the incoming discretionary order as the provider of liquidity to the price sought by the resting order. When an incoming order is designated "Immediate or Cancel," however, a resting discretionary order with which the IOC order interacts would be deemed the liquidity provider, since a participant entering an IOC order would never expect the order to post on the SuperMontage book, and would therefore be deemed the liquidity accessor in all circumstances.

#### 2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 15A of the Act,<sup>9</sup> in general, and with Section 15A(b)(5) of the Act,<sup>10</sup> in particular, in that it provides for the equitable allocation of reasonable dues, fees and other charges among members and issuers, and other persons using any facility or system which the NASD operates or controls. The proposed rule change clarifies the circumstances under which a discretionary order is deemed to provide liquidity or access liquidity for purposes of assessment of execution fees and credits, based upon the reasonable expectations of parties to transactions involving discretionary orders.

### 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.

<sup>6</sup> See Securities Exchange Act Release No. 49085 (January 15, 2004), 69 FR 3412 (January 23, 2004) (Order approving File No. SR-NASD-2003-165).

<sup>7</sup> See Securities Exchange Act Release No. 48868 (December 3, 2003), 68 FR 68677 (December 9, 2003) (Notice for File No. SR-NASD-2003-165).

<sup>8</sup> Telephone conversation between John M. Yetter, Associate General Counsel, Nasdaq and Marc McKayle, Special Counsel, Division, Commission on February 17, 2004.

<sup>9</sup> 15 U.S.C. 78o-3.

<sup>10</sup> 15 U.S.C. 78o-3(b)(5).

### 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)(ii) of the Act,<sup>11</sup> and subparagraph (f)(2) of Rule 19b-4 thereunder,<sup>12</sup> because it establishes or changes a due, fee, or other charge imposed by the self-regulatory organization. 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.<sup>13</sup>

### 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. 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-2004-019. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, comments should be sent in hard copy 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 NASD. All submissions should refer to File No. SR-NASD-2004-019 and should be submitted by March 16, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>14</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49263; File No. SR-PCX-2004-05]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Pacific Exchange, Inc. To Amend Its Rules To Impose a Connectivity Fee Applicable to Non-Members That Maintain a Connectivity Line With the Exchange

February 17, 2004.

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 January 28, 2004, the Pacific Exchange, Inc. ("PCX" or "Exchange") 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 the Exchange. 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

The Exchange is proposing to amend the Floor, Market Maker and Remote Market Maker Fees portion of its Schedule of Fees and Charges ("Schedule"). The text of the proposed change to the fee schedule is available at the Exchange and at the Commission.

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange 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. The Exchange 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

The Exchange is proposing to amend the Floor, Market Maker and Remote Market Maker portion of its Schedule in order to create a connectivity fee of \$300 per line per month that would be applicable to non-members that maintain a connectivity line with the Exchange.

On December 12, 2003, the Exchange filed a proposed rule change to implement a connectivity fee applicable to members of the Exchange.<sup>3</sup> This fee became effective upon filing.<sup>4</sup> At this time, the Exchange wishes to implement the same connectivity fee applicable non-members.<sup>5</sup> As the Exchange previously stated, it maintains a significant number of telecommunications lines that support connectivity from various routing firms from both members and non-members of the Exchange. Thus, the PCX dedicates a significant amount of resources to installation and maintenance. The installation and maintenance costs for these lines are the same for members and non-members. Therefore, the Exchange believes that the proposed fee will provide for the cost recovery of the expenses incurred as part of the initial deployment and ongoing testing of these lines.

##### 2. Statutory Basis

The Exchange believes that the proposal is consistent with Section 6(b) of the Act,<sup>6</sup> in general, and Section 6(b)(4) of the Act,<sup>7</sup> in particular, in that it provides for the equitable allocation of reasonable dues, fees and other charges among its members and other persons using its facilities.

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

The Exchange does not believe that the proposed rule change will impose

<sup>3</sup> See Securities Exchange Act Release No. 48970 (December 22, 2003), 68 FR 75306 (December 30, 2003) (SR-PCX-2003-67).

<sup>4</sup> See Section 19(b)(3)(A)(ii) of the Act. 15 U.S.C. 78s(b)(3)(A)(ii).

<sup>5</sup> The Exchange does not anticipate that a significant number of non-members will be billed as a result of this proposed rule change. However, the proposed rule change attempts to align the connectivity fee with the parties that are establishing connections with this market center, irrespective of whether the parties are members. Accordingly, the Exchange is expanding the scope of the connectivity fee so that it can appropriately assess the fee on non-member firms such as correspondents and service bureaus.

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

<sup>7</sup> 15 U.S.C. 78f(b)(4).

<sup>11</sup> 15 U.S.C. 78s(b)(3)(A)(ii).

<sup>12</sup> 17 CFR 240.19b-4(f)(2).

<sup>13</sup> For the purpose of calculating the 60-day abrogation period, and the date that the proposed rule change is immediately effective, the Commission considers the proposed rule change to have been filed on February 10, 2004; the date Nasdaq filed Amendment No. 2.

<sup>14</sup> 17 CFR 200.30-3(a)(12).

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

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