provisions in debt securities and preferred stock.

The Commission will also consider whether to propose amendments to Form N–1A with respect to the disclosure of sales loads and revenue sharing payments.

For further information, please contact Joshua Kans at (202) 942–0073 concerning rules 15c2–2, 15c2–3 and 10b–10, and Tara Royal at (202) 942–7973 concerning Form N–1A.

The subject matter of the Closed Meeting scheduled for Thursday, January 15, 2004 will be: Report of an investigation.

At times, changes in Commission priorities require alterations in the scheduling of meeting items. For further information and to ascertain what, if any, matters have been added, deleted or postponed, please contact: The Office of the Secretary at (202) 942–7070.

Dated: January 7, 2004.

Jonathan G. Katz,

Secretary.

[FR Doc. 04–677 Filed 1–8–04; 12:11 pm]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–49020; File No. SR–NASD–2003–143]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Granting Approval to a Proposed Rule Change and Amendments Nos. 1, 2, and 3 Thereto to Establish a New ''Auto-Ex'' Order in Nasdaq's SuperMontage System

January 5, 2004.

I. Introduction

On September 24, 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''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] and Rule 19b–4 thereunder,[2] a proposed rule change to establish an ''Auto-Ex'' order in Nasdaq's National Market Execution System (''NNMS'' or ''SuperMontage''). Nasdaq filed Amendment Nos. 1 and 2 to the proposed rule change on October 3, 2003,[3] and October 21, 2003,[4] respectively. The proposed rule change, as amended, was published for comment in the **Federal Register** on October 28, 2003.[5] The Commission received two comment letters on the proposal.[6] In addition, Nasdaq submitted a response to comments.[7] Nasdaq also submitted Amendment No 3. to the proposed rule change on December 17, 2003.[8] This order approves the proposed rule change, as amended.

II. Description of the Proposed Rule Change

Nasdaq proposes to establish an Auto-Ex order for use in SuperMontage. Auto-Ex orders may be either priced limit orders or market orders, and all market participants would be permitted to enter Auto-Ex orders. Auto-Ex orders would execute solely against the Quotes/Orders of SuperMontage participants that participate in the system's automatic execution functionality and do not charge a separate quote-access fee to participants accessing their Quotes/Orders through SuperMontage. Auto-Ex orders would access all available liquidity at multiple price levels, but under no circumstances would the order trade-through the Quote/Order of an Order-Delivery electronic communications network (''ECN'') or an automatic execution participant that charged an access fee to access liquidity at another price level. Thus, an Auto-Ex order would automatically be designated ''Immediate or Cancel,'' and the order (or any unexecuted portion thereof) would be cancelled whenever the best price available through SuperMontage solely reflects the Quote/Order of a market participant that is not eligible to receive the Auto-Ex order.

Nasdaq intends to implement the Auto-Ex order as soon as possible following Commission approval, and will inform market participants of the exact implementation date via a Head Trader alert on *http://www.nasdaqtrader.com*.

III. Summary of Comments and Nasdaq's Response

As noted above, the Commission received two comment letters on the proposed rule change.[9] Both commenters, Inet and Bloomberg, opposed the Commission's approval of the proposed rule change.

Inet and Bloomberg stated that the proposed rule change discriminates against ECNs by creating an order type that would bypass ECNs in favor of automatic execution participants. Both commenters questioned the primary rationale offered by Nasdaq in the Notice that the proposal would benefit market participants that seek speed and certainty of executions. For example, Inet noted that the Auto-Ex order would also bypass automatic execution participants that charged quote access fees, and questioned whether the true motivation of the proposal was to enhance speed of execution for market participants or provide for the systemic discrimination against ECNs in SuperMontage.[10] Inet suggested that Nasdaq should establish criteria to differentiate between Order-Delivery ECNs that have consistently rapid order response times and those that have comparative slow order response times (on a regular or intermittent basis) by creating criteria under the proposal that would establish an acceptable ECN response time. Bloomberg also expressed doubts about Nasdaq's rationale because, in a race condition, a participant entering an order into SuperMontage may not have its order filled against an automatic execution participant if that participant's trading interest (bid or offer) was satisfied a split-second before.

In addition, both commenters stated that implementation of an Auto-Ex order would undercut the principles of price/time priority in SuperMontage. Further, Inet stated that Nasdaq's

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* letter to Katherine A. England, Assistant Director, Division of Market Regulation (''Division''), Commission, from Mary M. Dunbar, Vice President and Deputy General Counsel, Nasdaq, dated October 2, 2003 (''Amendment No. 1'').

[4] *See* letter to Katherine A. England, Assistant Director, Division, Commission, from John M. Yetter, Associate General Counsel, Nasdaq, dated October 21, 2003 (''Amendment No. 2'').

[5] *See* Securities Exchange Act Release No. 48675 (October 21, 2003), 68 FR 61528 (''Notice'').

[6] *See* letters to Jonathan G. Katz, Secretary, Commission, from Kim Bang, Bloomberg Tradebook LLC (''Bloomberg''), dated November 20, 2003 (''Bloomberg Letter''), and Alex Goor, President, Inet ATS, Inc. (''Inet''), dated November 18, 2003 (''Inet Letter'').

[7] *See* letter to Jonathan G. Katz, Secretary, Commission, from Edward S. Knight, Executive Vice President, Nasdaq, dated December 8, 2003 (''Nasdaq Letter'').

[8] *See* letter to Katherine A. England, Assistant Director, Division, Commission, from John M. Yetter, Associate General Counsel, Nasdaq, dated December 16, 2003 (''Amendment No. 3''). In Amendment No. 3, Nasdaq amended the proposed rule text to reflect the immediate effectiveness of SR–NASD–2003–150. *See* Securities Exchange Act Release No. 48798 (November 17, 2003) (Notice of Filing and Immediate Effectiveness of SR–NASD–2003–150). The Commission notes that this is a technical, non-substantive amendment and not subject to notice and comment.

[9] *See supra* note 6.

[10] *See also* Bloomberg Letter. Bloomberg and Inet also noted that Nasdaq acknowledged that the average ECN response time is one second or less. *See supra* note 6.

comparison of the proposed Auto-Ex order type with the ''Fill-or-Return'' order on the Archipelago Exchange (''ArcaEx''), a trading facility of Pacific Exchange Equities, Inc. (''PCXE''), was inapposite. Inet asserted that unlike Nasdaq's proposed order type, the ArcaEx Fill-or-Return order distinguishes between providing executions on ArcaEx and routing to other market centers, not between ArcaEx market participants. According to Inet, Fill-or-Return orders execute in price/time priority against all contra-side orders available in ArcaEx, while the Auto-Ex order would ignore ECN orders represented in SuperMontage. Lastly, Bloomberg indicated that Nasdaq's assertion of the applicability of the Commission's rationale in the SuperSOES approval order was factually inaccurate and that the proposed rule change would marginalize ECNs and is anti-competitive.

In its response letter, Nasdaq asserted that the proposed Auto-Ex order was not unfairly discriminatory or anticompetitive. Nasdaq believed that the proposal would provide Nasdaq market participants with greater flexibility in determining the terms and conditions under which orders routed to SuperMontage would interact with orders in SuperMontage. Specifically, Nasdaq stated that a market participant could opt to use an Auto-Ex order to: (1) Receive rapid executions, (2) avoid ECN access fees and Nasdaq's $0.001 per share routing fee to ECNs, and (3) avoid the duplicate routing of orders to ECNs through direct connections and SuperMontage.

Nasdaq also emphasized that the Auto-Ex order was just one option available to market participants. According to Nasdaq, market participants that seek to achieve greater certainty that their orders will be executed in full, or that prefer to access all available liquidity though a single order, will not opt to use the Auto-Ex order. Moreover, when an ECN Quote/Order is the predominant source of liquidity at the inside in a particular stock, market participants would simply not use the Auto-Ex order. Moreover, Nasdaq noted that ECNs are provided further protection because Auto-Ex orders cannot trade-through the Quote/Order of a market participant that is not eligible to receive such an order.

Nasdaq also responded to Inet's contention that its comparison of the Auto-Ex order to ArcaEx's Fill-or-Return order was inapposite. Nasdaq stated ArcaEx participants must accept automatic execution and do not have the option of a status comparable to Order-Delivery ECNs. Nasdaq asserted that ArcaEx's market structure effectively excludes ECNs from direct participation, puts ECNs last in line for ArcaEx liquidity, and allows market participants to use the Fill-or-Return order to avoid accessing ECN liquidity under any circumstances. Nasdaq also noted that ECNs—Bloomberg, Island, and Instinet—have similar order types. Thus, according to Nasdaq, its market participants should have the same flexibility.

In response to Bloomberg's comment that Nasdaq's comparison of the Auto-Ex Order to SuperSOES was inaccurate, Nasdaq stated that SuperSOES order processing was virtually identical to Auto-Ex orders, because SuperSOES orders accessed liquidity available from automatic execution participants and were cancelled upon interacting with the quote of an order delivery participant. Nasdaq did note that SuperMontage differs from SuperSOES/SelectNet in that order delivery and automatic execution participants can be accessed by a single point of entry. However, Nasdaq reasoned that the SuperMontage unified point of entry for order delivery and automatic execution provided market participants with more options than were available during the operation of SuperSOES/SelectNet for accessing Order-Delivery ECNs, and in light of the enhanced accessibility of ECNs in SuperMontage, Nasdaq should not be foreclosed from providing a functionality that existed through SuperSOES/SelectNet.

Finally, Nasdaq responded to Inet's suggestion that it develop criteria for ECN response times. Nasdaq did not believe it was technically feasible to impose a response time standard that would ensure that executions of ECN-delivered orders would always be as fast as automatic executions. Nasdaq noted that the processing time for automatic executions is between .006 and .01 seconds. According to Nasdaq, although the average response time and average processing time for Order-Delivery ECNs is less than one second, particular orders may be much slower and the averages are invariably higher during the market open and market close. For example, Nasdaq stated that the average round-trip processing time for all order-delivery orders during the market close exceeded one second on the majority of trading days. Further, Nasdaq indicated that automatic execution participants, unlike ECNs, cannot simply back away from their Quotes/Orders because of trades preformed elsewhere or because it chooses not to do business with a contra-party. Thus, Nasdaq contended that the Auto-Ex order would simply provide market participants with a voluntary tool to use when they wish to ensure a rapid execution, rather than running the risk of a delay in a fast-moving market.

IV. Discussion

After careful consideration of the proposed rule change, the comment letters, and Nasdaq's response, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association [11] and, in particular, the requirements of Section 15A of the Act [12] and the rules and regulations thereunder. Specifically, the Commission believes that the proposed rule change is consistent with Section 15A(b)(6) of the Act,[13] which, among other things, requires that NASD's rules be 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.

The Commission notes that Inet and Bloomberg believed that the proposed Auto-Ex order unfairly discriminates against Order-Delivery ECNs or is anti-competitive. The Commission acknowledges that the Auto-Ex order will treat Order-Delivery ECNs and automatic execution participants that charge a fee differently than automatic execution participants that do not charge a fee. However, the Commission believes that the proposal accommodates the various needs and interests of market participants in SuperMontage by taking into account the needs and business models of ECNs, while providing Nasdaq market participants with an optional order type that may enhance the ability of market participants to control costs associated with executing an order, such as avoiding the Nasdaq ECN order routing fee and allowing such participants to route orders directly to ECNs.

The Commission notes Order-Delivery ECNs would continue to be able to participate in SuperMontage. The Auto-Ex order would only execute at the Nasdaq best bid or offer and would not

[11] In approving this proposed rule change, the Commission notes that it has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[12] 15 U.S.C. 78*o*–3.

[13] 15 U.S.C. 78*o*–3(b)(6).

trade-through the price of a market participant that does not accept automatic execution or charges a quote access fee. Thus, ECNs that provide depth and liquidity at or near the inside market would continue to receive executions. In addition, the use of Auto-Ex orders would be voluntary and there may be many instances where this order type would not be appropriate. For example, as stated by Nasdaq, use of an Auto-Ex order may be inappropriate where an ECN's Quote/Order is the predominant source of liquidity at the inside market for a particular stock or when a market participant seeks to access all available liquidity though SuperMontage.[14] In the latter example, a market participant may elect to use a regular non-directed order, rather than the Auto-Ex order. Therefore, the Commission believes that the Auto-Ex order is reasonably designed to accommodate the participation of ECNs and other market participants in SuperMontage, to give market participants greater flexibility in determining how their orders will be executed, and to provide greater opportunities to control execution and routing costs.

Inet and Bloomberg commented that the Auto-Ex order ''undercuts'' the principle of price/time priority in SuperMontage. However, the Commission notes that SuperMontage has never been a trading environment characterized by strict price/time priority. For example, SuperMontage has order execution algorithms based on price/size/time and price/time taking into account ECN fees, which may be used on an order-by-order basis, as well as Preferenced Orders, which execute solely against the Quote/Order of a recipient identified by the participant entering the order at the best bid or offer regardless of the recipient's time priority within the price level, and Directed Orders, which can be directed to a particular market participant at any price. The Commission notes that the Auto-Ex order, while not identical, has functional similarities to these current Nasdaq features, including the order execution algorithm based on price/time priority that takes access fees into account and Preferenced Orders.

Inet also commented that the Auto-Ex order was not like the ArcaEx Fill-or-Return order. The Commission recognizes that distinctions may be drawn between the Auto-Ex order and the ArcaEx Fill-or-Return order. Nonetheless, the Commission believes that the Auto-Ex order provides functionality and flexibility for market participants that is similar to the ArcaEx Fill-or-Return order. In particular, the Auto-Ex order, like the Fill-or-Return order, permits a market participant to determine whether its order will be routed away to an alternate market. Thus, while the Auto-Ex order is not identical to the Fill-or-Return order, both orders give the market participant some ability to control where its order is routed.

The Commission also believes that the proposed Auto-Ex order may provide greater speed and certainty of execution. The Commission recognizes that an Order-Delivery ECN may determine to reject an order to avoid dual liability or because a fee dispute exists with a contra-party. If an order is rejected and returned to SuperMontage, market conditions, especially during a fast market, may change and the order may receive an inferior execution. Thus, the Commission believes that an Auto-Ex order may help to assure the quality of execution in certain market conditions. The Commission also notes that market participants that have access fee disputes with ECNs could use the Auto-Ex order to avoid ECNs that will reject their orders. In such an instance, the Commission believes that the use of an Auto-Ex order may benefit the Order-Delivery ECN and the market participant with which the fee dispute exists as the respective interest of the parties could potentially interact with contra-parties with which no fee dispute exists.

Notwithstanding the foregoing, the Commission emphasizes that broker-dealers must evaluate whether the use of the Auto-Ex order type is consistent with their best execution obligations. As the Commission has previously stated, the customer's instructions and expectations should determine the order handling procedures that a broker-dealer employs and whether the execution of an order is the best under the circumstances. Without specific instructions from a customer, however, a broker-dealer should periodically assess the quality of competing markets to ensure that its order flow is directed to markets providing the most advantageous terms for the customer's order.[15] Currently, market participants have the choice, in part, of using Nasdaq's facility to access liquidity or private linkages outside of SuperMontage to access liquidity. As a result, broker-dealers must be able to identify the best available terms among multiple competing marketplaces and be able to access those marketplaces.[16] An inability to reach quotations and execute among market centers can compromise a broker-dealer's ability to satisfy its duty of best execution. For example, it could be inconsistent with a broker-dealer's duty of best-execution to use Auto-Ex orders if such use regularly leads to a failure to obtain the best available price for customers' orders. Thus, while the Commission has permitted Nasdaq to develop a market structure that gives its market participants operational flexibility, the Commission emphasizes that market participants must utilize SuperMontage functions in a manner that is consistent with their best execution obligations.

V. Conclusion

For the foregoing reasons, the Commission finds that the proposal is consistent with the requirements of the Act and rules and regulations thereunder.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[17] that the proposed rule change and Amendment Nos. 1, 2, and 3 thereto (File No. SR–NASD–2003–143) are approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[18]

Jill M. Peterson,

Assistant Secretary.

[FR Doc. 04–524 Filed 1–9–04; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–49018; File No. SR–PCX–2003–49]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 by the Pacific Exchange, Inc. Eliminating the Requirement that Market Makers With No Public Accounts and Who Do Not Solicit Public Accounts, Maintain Certain Information Barriers

January 5, 2004.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on September 16, 2003, the Pacific Exchange, Inc. (''PCX'' or ''Exchange''), through its subsidiary, PCX Equities,

[14] *See* Nasdaq Letter, *supra* note 7.

[15] *See Market 2000: An Examination of Current Equity Market Developments,* Division, Commission, (January 1994), Study V at 4.

[16] *See* Securities Exchange Act Release No. 43863 (January 19, 2001), 66 FR 8020 (January 26, 2001) (Order approving SR–NASD–99–53).

[17] 15 U.S.C. 78s(b)(2).

[18] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.