

MEMO# 12917

December 7, 2000

INSTITUTE COMMENT LETTER ON AMENDMENT NO. 8 TO SUPERMONTAGE PROPOSAL

[12917] December 7, 2000 TO: EQUITY MARKETS ADVISORY COMMITTEE No. 61-00 SEC RULES COMMITTEE No. 130-00 RE: INSTITUTE COMMENT LETTER ON AMENDMENT NO. 8 TO SUPERMONTAGE PROPOSAL The Institute has filed a comment letter (attached) with the Securities and Exchange Commission on Amendment No. 8 to Nasdaq's SuperMontage proposal. The comment letter reiterates the Institute's support for the objectives of SuperMontage, in particular, increasing the transparency of limit orders in the Nasdaq market and the ability of those orders to interact with one another. The letter also states that the Institute is pleased that Nasdaq has proposed in Amendment No. 8 changes intended to address several concerns of the Institute with prior versions of SuperMontage. The letter states, however, that Amendment No. 8 introduces additional changes to SuperMontage that, in the Institute's view, would significantly diminish the potential benefits of the proposed system including (1) the introduction of a new type of order, the "preferred order," and (2) the introduction of a new execution algorithm for non-directed orders that would be based on price/size/time priority. Preferred Orders The comment letter states that the introduction of preferred orders, which would allow a market participant to designate a particular quoting market participant against which its order is to be executed or delivered, is unnecessary and would offer little, if any, benefits to the proposed SuperMontage system. In particular, the letter states that allowing market participants to send preferred orders inside the SuperMontage system would undermine the concept of price/time priority by allowing market participants to preference market participants that lack priority status, and thus damage the integrity of the Nasdaq market. In addition, it is likely that such orders could be used as a mechanism to facilitate such practices as internalization and payment for order flow. The Institute therefore strongly recommends that preferred orders be eliminated from the proposed SuperMontage system. Price/Size/Time Priority The comment letter states that while the Institute supports the two algorithms that follow price/time priority (because they would resolve the dispute over how to treat ECN access fees within SuperMontage while maintaining adherence to the principle of price/time 2priority), nothing compels the introduction of a third alternative based on price/size/time. The Institute believes that, like preferred orders, the price/size alternative is seriously flawed because it would undermine the concept of price/time priority. In addition, ranking orders/quotes based on displayed size will have little effect on the ability of market participants to complete large orders as market participants will still have the ability to sweep through a certain price level under the two remaining algorithms as well as have the option to utilize directed orders to send an order to a market participant displaying greater size. The Institute therefore recommends that the price/size option be

eliminated from the proposed SuperMontage system. Other Comments The comment letter reiterates the Institute's earlier comments on the proposal that further enhancements to SuperMontage that would increase the number of price levels displayed in the system, particularly after the conversion to decimalization is completed, should be pursued. In addition, the letter reiterates the Institute's opposition to the "built-in" internalization capability of the proposed system, which would be preserved in all three of the proposed execution algorithms under Amendment No. 8. Finally, the letter states that the Institute is pleased that Nasdaq is proposing certain clarifying amendments in Amendment No. 8 regarding UTP exchanges and encourages Nasdaq to continue working with market participants to develop an approach that would treat UTP exchanges in a mutually satisfactory manner. Ari Burstein Associate Counsel Attachment (in .pdf format)

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