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Part VI

## Securities and Exchange Commission

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**Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval on a Pilot Basis to a Proposed Rule Change by the National Association of Securities Dealers, Inc., Relating to the Operation of the Alternative Display Facility for Quoting and Trading in Securities of the Nasdaq Stock Market, Inc.; Notice**

**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-46249; File No. SR-NASD-2002-97]

**Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval on a Pilot Basis to a Proposed Rule Change by the National Association of Securities Dealers, Inc., Relating to the Operation of the Alternative Display Facility for Quoting and Trading in Securities of The Nasdaq Stock Market, Inc.**

July 24, 2002.

The Commission is approving the National Association of Securities Dealers, Inc.'s ("NASD's" or "Association's") Alternative Display Facility ("ADF") for Nasdaq stocks for a nine-month pilot period. This proposal for a pilot was filed with the Securities and Exchange Commission ("SEC" or "Commission") 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> on July 22, 2002, by the NASD. In this proposal, as described by the NASD in Items I, II, and III below, the NASD proposes to establish, implement, and operate the ADF on a pilot basis ("ADF Pilot"). As discussed below, the Commission is granting accelerated approval of the proposed rule change for a pilot period to expire at the close of daily operation of the ADF Pilot on April 24, 2003. The rules related to the establishment, implementation, and operation of the Pilot ADF are substantially similar to the proposed permanent rules contained in the original ADF proposal related to the establishment, implementation, and operation of the permanent ADF.<sup>3</sup>

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

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

<sup>3</sup> See Securities Exchange Act Release Nos. 45156 (December 14, 2002), 67 FR 388 (January 3, 2002) (Notice of filing of SR-NASD-2001-90); 45278 (January 14, 2002), 67 FR 3252 (January 23, 2002) (Extending the public comment period for SR-NASD-2001-90); 45501 (March 4, 2002), 67 FR 10942 (March 11, 2002) (Notice of filing of SR-NASD-2002-28 relating to ADF fees); 45991 (May 28, 2002), 67 FR 39476 (June 7, 2002) (Notice of filing of Amendment No. 2 to SR-NASD-2001-90) (collectively, "ADF Proposal"). The Commission intends to approve simultaneously and set an identical effective date for SR-NASD-2001-90 and SR-NASD-2002-28. The Commission notes that the ADF Proposal contains additional proposed rules not contained in the ADF Pilot. For instance, the ADF Proposal contains rules related to the separation of the NASD and the Nasdaq Stock Market, Inc. ("Nasdaq") corporate entities. 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 NASD proposes to establish, implement, and operate, on a pilot basis, the ADF. For purposes of this ADF Pilot, NASD members will be able to quote and trade only Nasdaq securities on or through the Pilot ADF. The text of the proposed rule change is below. Additions are in *italics*, and deletions are in brackets.

*IM-2110-5. Anti-Intimidation/Coordination*

The Board of Governors is issuing this interpretation to codify a longstanding policy. It is conduct inconsistent with just and equitable principles of trade for any member or person associated with a member to coordinate the prices (including quotations), trades, or trade reports of such member with any other member or person associated with a member; to direct or request another member to alter a price (including a quotation); or to engage, directly or indirectly, in any conduct that threatens, harasses, coerces, intimidates, or otherwise attempts improperly to influence another member or person associated with a member. This includes, but is not limited to, any attempt to influence another member or person associated with a member to adjust or maintain a price or quotation, whether displayed on any [automated system] *facility* operated by *NASD* [The Nasdaq Stock Market, Inc. (Nasdaq),] or otherwise, or refusals to trade or other conduct that retaliates against or discourages the competitive activities of another market maker or market participant. Nothing in this interpretation respecting coordination of quotes, trades, or trade reports shall be deemed to limit, constrain, or otherwise inhibit the freedom of a member or person associated with a member to:

- (1) set unilaterally its own bid [and] or ask in any [Nasdaq] security, the prices at which it is willing to buy or sell any [Nasdaq] security, and the quantity of shares of any [Nasdaq] security that it is willing to buy or sell;
- (2) set unilaterally its own dealer spread, quote increment, or quantity of shares for its quotations (or set any relationship between or among its dealer spread, inside spread, or the size of any quote increment) in any [Nasdaq] security;
- (3) communicate its own bid or ask, or the prices at or the quantity of shares in which it is willing to buy or sell any [Nasdaq] security to any person, for the purpose of exploring the possibility of a purchase or sale of that security, and to

negotiate for or agree to such purchase or sale;

(4) communicate its own bid or ask, or the price at or the quantity of shares in which it is willing to buy or sell any [Nasdaq] security, to any person for the purpose of retaining such person as an agent or subagent for the member or for a customer of the member (or for the purpose of seeking to be retained as an agent or subagent), and to negotiate for or agree to such purchase or sale;

(5) through (7) No Change.

\* \* \* \* \*

2700. SECURITIES DISTRIBUTIONS

\* \* \* \* \*

2720. Distribution of Securities of Members and Affiliates—Conflicts of Interest

- (a) No Change.
- (b) Definitions  
For purposes of this Rule, the following words shall have the stated meanings:  
(1) through (3) No Change.  
(4) Bona fide independent market maker—a market maker [which] *that*:  
(A) is registered as a Nasdaq *or ADF* market maker in the security to be distributed pursuant to this Rule;  
(B) through (C) No Change.  
(5) through (18) No Change.  
(c) through (p) No Change.

\* \* \* \* \*

3340. Prohibition on Transactions, Publication of Quotations, or Publication of Indications of Interest During Trading Halts

No member or person associated with a member shall, directly or indirectly, effect any transaction or publish a quotation, a priced bid and/or offer, an unpriced indication of interest (including "bid wanted" and "offer wanted" and name only indications), or a bid or offer accompanied by a modifier to reflect unsolicited customer interest, in any security as to which a trading halt is currently in effect. *If ADF closes trading in Nasdaq securities pursuant to its authority under Rule 4120A(a)(2), members would not be prohibited from trading through other markets for which trading is not halted.*

3350. Short Sale Rule

- (a) No member shall effect a short sale for the account of a customer or for its own account in a Nasdaq National Market security at or below the current *national* best (inside) bid when the current *national* best (inside) bid [as displayed by The Nasdaq Stock Market] is below the preceding *national* best (inside) bid in the security.  
(b) No Change.

(c) The provisions of paragraph (a) shall not apply to:

(1) Sales by a qualified market maker or an ADF market maker registered in the security in connection with bona fide market making activity. For purposes of this paragraph, transactions unrelated to normal market making activity, such as index arbitrage and risk arbitrage that are independent from a member's market making functions, will not be considered bona fide market-making activity.

(2) through (8) No Change.

(d) through (e) No Change.

(f) A member that is not currently registered as a Nasdaq or ADF market maker in a security and that has acquired a security while acting in the capacity of a block positioner shall be deemed to own such security for the purposes of this Rule notwithstanding that such member may not have a net long position in such security if and to the extent that such member's short position in such security is the subject of one or more offsetting positions created in the course of bona fide arbitrage, risk arbitrage, or bona fide hedge activities.

(g) through (h) No Change.

(i)(1) A member shall be permitted, consistent with its quotation obligations, to execute a short sale for the account of a warrant market maker that would otherwise be in contravention of this Rule, if:

(A) the warrant market maker is a registered Nasdaq or ADF market maker for the warrant; and

(B) No Change.

(j) through (l) No Change.

\* \* \* \* \*

*IM-3350. Short Sale Rule*

(a) (1) In developing a Short Sale Rule for Nasdaq National Market securities, [the Association] NASD adopted an exemption to the Rule for certain market making activity. This exemption was deemed an essential component of the Rule because bona fide market making activity is necessary and appropriate to maintain continuous, liquid markets in Nasdaq National Market securities. Rule 3350(c)(1) states that short selling prohibitions shall not apply to sales by qualified Nasdaq market makers or registered ADF market makers in connection with bona fide market making activity and specifies that transactions unrelated to normal market making activity, such as index arbitrage and risk arbitrage that are independent from a member's market making functions, will not be considered as bona fide market making. Thus two standards are to be applied: one must be a "qualified" Nasdaq market maker or a

registered ADF market maker and one must engage in "bona fide" market making activity to take advantage of this exemption. With this interpretation, [the Association] NASD wishes to clarify for members some of the factors that will be taken into consideration when reviewing market making activity that may not be deemed to be bona fide market making activity and therefore would not be exempted from the Rule's application.

(2) through (3) No Change.

(b) [(1)] Rule 3350 requires that no member shall effect a short sale for the account of a customer or for its own account in a Nasdaq National Market security at or below the current national best (inside) bid when the current national best (inside) bid [as displayed by The Nasdaq Stock Market] is below the preceding national best (inside) bid in the security. [The Association] NASD has determined that in order to effect a "legal" short sale when the current best bid is lower than the preceding best bid the short sale must be executed at a price of at least \$0.01 above the current inside bid when the current inside spread is \$0.01 or greater. The last sale report for such a trade would, therefore, be above the inside bid by at least \$0.01.

(c) (1) No Change.

(2) For example, in instances where the current best bid is below the preceding best bid, if a market maker alone at the inside best bid were to lower its bid and then raise it to create an "up bid" for the purpose of facilitating a short sale, [the Association] NASD would consider such activity to be a manipulative act and a violation of [the Association's] NASD's Short Sale Rule. NASD [The Association] also would consider it a manipulative act and a violation of the Rule if a market maker with a long stock position were to raise its bid above the inside bid and then lower it to create a "down bid" for the purpose of precluding market participants from selling short. In addition, if a market maker agrees to an arrangement proposed by a member or a customer whereby the market maker raises its bid in The Nasdaq Stock Market or in the ADF in order to effect a short sale for the other party and is protected against any loss on the trade or on any other executions effected at its new bid price, the market maker would be deemed to be in violation of Rule 3350. Similarly, a market maker would be deemed in violation of the Rule if it entered into an arrangement with a member or a customer whereby it used its exemption from the rule to sell short at the bid at successively lower prices, accumulating a short position, and subsequently

offsetting those sales through a transaction at a prearranged price, for the purpose of avoiding compliance with the Rule, and with the understanding that the market maker would be guaranteed by the member or customer against losses on the trades.

(3) No Change.

\* \* \* \* \*

3370. Prompt Receipt and Delivery of Securities

(a) No Change.

(b) (1) No Change.

(2) "Short Sales"

(A) No Change.

(B) Proprietary short sales.

No member shall effect a "short" sale for its own account in any security unless the member or person associated with a member makes an affirmative determination that the member can borrow the securities or otherwise provide for delivery of the securities by the settlement date. This requirement will not apply to transactions in corporate debt securities, to bona fide market making transactions by a member in securities in which it is registered as a Nasdaq or ADF market maker, to bona fide market maker transactions in non-Nasdaq securities in which the market maker publishes a two-sided quotation in an independent quotation medium, or to transactions [which] that result in a fully hedged or arbitrated position.

(C) No Change.

(3) through (5) No Change.

\* \* \* \* \*

4000. THE NASDAQ STOCK MARKET

\* \* \* \* \*

4619. Withdrawal of Quotations and Passive Market Making

(a) A market maker that wishes to withdraw quotations in a security or have its quotations identified as the quotations of a passive market maker shall contact Nasdaq Market Operations to obtain excused withdrawal status prior to withdrawing its quotations or identification as a passive market maker. If a Registered Reporting Nasdaq market maker also is a Registered Reporting ADF Market Maker as defined in Rule 5420, it must obtain excused withdrawal status in both facilities for the same time period. Withdrawals of quotations or identifications of quotations as those of a passive market maker shall be granted by Nasdaq Market Operations only upon satisfying one of the conditions specified in this Rule.

\* \* \* \* \*

**4600. NASDAQ MARKET MAKER REQUIREMENTS**

*This Rule 4600 Series applies to quotation and trading activities by Nasdaq market makers, ATS or ECNs in The Nasdaq Stock Market, Inc. operated on behalf of NASD by the Nasdaq Stock Market, Inc.*

\* \* \* \* \*

**4630. Reporting Transactions in Nasdaq National Market Securities**

This Rule 4630 Series applies to the reporting by [all] members of transactions in Nasdaq National Market securities ("designated securities") through the Automated Confirmation Transaction Reporting Service (ACT). [These securities have been designated pursuant to the "National Market System Securities Designation Plan with Respect to Nasdaq Securities" ("Plan") which has been approved by the Commission pursuant to SEC Rule 11Aa2-1.]

**4631. Definitions**

[(a)] Terms used in this Rule 4630 Series shall have the meaning as defined in [the Association's] *NASD's By-Laws and Rules, SEC Rule 11Aa2-1 and the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation, and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on Exchanges on an Unlisted Trading Privilege Basis* [Plan], unless otherwise defined herein.

Paragraphs (b) through (d) are renumbered as paragraphs (b) through (d) of proposed Rule 5420.

**4632. Transaction Reporting**

Paragraphs (a) and (b) are renumbered as paragraphs (a) and (b) of proposed Rule 5430.

**(a) When and How Transactions Are Reported**

*Members shall comply with Rule 5430(a) for determining when and how transactions are reported.*

**(b) Which Party Reports Transaction**

*Members shall comply with Rule 5430(b) for determining which party reports a transaction.*

(c) No Change.

**(d) Procedures for Reporting Price and Volume**

Members [which] *that* are required, *or have the option*, to report transactions using ACT, pursuant to paragraph (b) above shall transmit last sale reports for all purchases and sales in designated securities in the following manner:

(1) For agency transactions, report the number of shares and the price excluding the commission charged.

Example:

SELL as agent 100 shares at 40 less a commission of \$12.50;

REPORT 100 shares at 40.

(2) For dual agency transactions, report the number of shares only once, and report the price excluding the commission charged.

Example:

SELL as agent 100 shares at 40 less a commission of \$12.50;

BUY as agent 100 shares at 40 plus a commission of \$12.50;

REPORT 100 shares at 40.

(3) (A) For principal transactions, except as provided below, report each purchase and sale transaction separately and report the number of shares and the price. For principal transactions which are executed at a price which includes a mark-up, mark-down or service charge, the price reported shall exclude the mark-up, mark-down or service charge. Such reported price shall be reasonably related to the prevailing market, taking into consideration all relevant circumstances including, but not limited to, market conditions with respect to the security, the number of shares involved in the transaction, the published bids and offers with size at the time of the execution (including the reporting firm's own quotation), the cost of execution and the expenses involved in clearing the transaction.

Example:

BUY as principal 100 shares from another member at 40 (no mark-down included);

REPORT 100 shares at 40.

[Example:]

BUY as principal 100 shares from a customer at 39 $\frac{7}{8}$  which includes a  $\frac{1}{8}$  mark-down from prevailing market at 40;

REPORT 100 shares at 40.]

Example:

BUY as principal 100 shares from a customer at 39.90 which includes a \$0.10 mark-down from prevailing market at 40;

REPORT 100 shares at 40.

[Example:]

SELL as principal 100 shares to a customer at 40 $\frac{1}{8}$ , which includes a  $\frac{1}{8}$  mark-up from the prevailing market of 40;

REPORT 100 shares at 40.]

Example:

SELL as principal 100 shares to a customer at 40.10, which includes a \$0.10 mark-up from the prevailing market of 40;

REPORT 100 shares at 40.

[Example:]

BUY as principal 10,000 shares from a customer at 39 $\frac{3}{4}$ , which includes a  $\frac{1}{4}$  mark-down or service charge from the prevailing market of 40;

REPORT 10,000 shares at 40.]

Example:

BUY as principal 10,000 shares from a customer at 39.75, which includes a \$0.25 mark-down or service charge from the prevailing market of 40;

REPORT 10,000 shares at 40.

(B) Exception: A "riskless" principal transaction in which a member after having received an order to buy a security, purchases the security as principal at the same price to satisfy the order to buy or, after having received an order to sell, sells the security as principal at the same price to satisfy the order to sell, shall be reported as one transaction in the same manner as an agency transaction, excluding the mark-up or mark-down, commission-equivalent, or other fee.

Example:

SELL as a principal 100 shares to another member at 40 to fill an existing order;

BUY as principal 100 shares from a customer at 40 minus a mark-down of \$12.50;

REPORT 100 shares at 40.

**(e) Transactions Not Required To Be Reported**

The following types of transactions shall not be reported:

(1) transactions executed through [the Computer Assisted Execution System (CAES),] the Nasdaq National Market Execution System ("NNMS"), the *Primex Auction System*, or the SelectNet service;

(2) through (6) No Change.

(f) No Change.

\* \* \* \* \*

**4640. Reporting Transactions in Nasdaq SmallCap Market Securities**

This Rule 4640 Series sets forth the [applicable reporting] requirements for reporting transactions in Nasdaq SmallCap Market securities ("designated securities") utilizing [Members shall utilize] the Automated Confirmation Transaction Service (ACT)[ for transaction reporting].

## 4641. Definitions

[(a)] Terms used in this Rule 4640 Series shall have the same meaning as those defined in [the Association's] *NASD's By-Laws and Rules, SEC Rule 11Aa2-1 and Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation, and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on Exchanges on an Unlisted Trading Privilege Basis*, unless otherwise specified herein.

Paragraphs (b) through (d) are renumbered as paragraphs (b) through (d) of Rule 5420.

## 4642. Transaction Reporting

Paragraphs (a) and (b) are renumbered as paragraphs (a) and (b) of proposed Rule 5430.

## (a) When and How Transactions are Reported

Members shall comply with Rule 5430(a) for determining when and how transactions are reported.

## (b) Which Party Reports Transaction

Members shall comply with Rule 5430(b) for determining which party reports a transaction.

(c) No Change.

## (d) Procedures for Reporting Price and Volume

Members [which] *that* are required, or *have the option*, to report *transactions using ACT*, pursuant to paragraph (b) above shall transmit last sale reports for all purchases and sales in designated securities in the following manner:

(1) through (3) No Change.

## (e) Transactions Not Required To Be Reported

The following types of transactions shall not be reported:

(1) transactions executed through [the Computer Assisted Execution System (CAES),] the *SmallCap* Small Order Execution System (SOES), the *Primex Auction System*, or the *SelectNet* service.

(2) through (5) No Change.

(f) No Change.

\* \* \* \* \*

## 4650. Reporting Transactions in Nasdaq Convertible Debt Securities

This Rule 4650 Series sets forth the applicable reporting requirements for transactions in convertible bonds that are listed on Nasdaq (designated securities). [Members shall utilize] *and reported utilizing* the Automated Confirmation Transaction Service (ACT) [for transaction reporting].

## 4651. Definitions

[(a)] Terms used in this Rule 4650 Series shall have the same meaning as those defined in [the Association's] *NASD's By-Laws and Rules*, unless otherwise specified herein.

Paragraphs (b) through (d) are renumbered as paragraphs (b) through (d) of Rule 5420.

## 4652. Transaction Reporting

Paragraphs (a) and (b) are renumbered as paragraphs (a) and (b) of Rule 5430.

## (a) When and How Transactions are Reported

Members shall comply with Rule 5430(a) for determining when and how transactions are reported.

## (b) Which Party Reports Transaction

Members shall comply with Rule 5430(b) for determining which party reports a transaction.

(c) No Change.

## (d) Procedures for Reporting Price and Volume

Members that are required, or *have the option*, to report *transactions using ACT*, pursuant to paragraph (b) above shall transmit last sale reports for all purchases and sales in designated securities in the following manner:

(1) through (3) No Change.

(e) and (f) No Change.

## 4000A. NASD Alternative Display Facility

## 4100A. General

*NASD Alternative Display Facility ("ADF") is the facility to be operated by NASD on a nine-month pilot basis for members that choose to quote or effect trades in Nasdaq securities ("ADF-eligible securities") otherwise than on Nasdaq or on an exchange. The ADF will collect and disseminate quotations, compare trades, and collect and disseminate trade reports. Those NASD members that utilize ADF systems for quotation or trading activities must comply with the Rule 4000A, Rule 5400 and Rule 6000A Series, as well as all other applicable NASD Rules. The ADF pilot will expire on [insert nine months from SEC approval date].* 4110A. Use of NASD Alternative Display Facility Data Systems.

*NASD may at any time authorize the use of NASD's Alternative Display Facility data systems on a test basis for whatever studies it considers necessary and appropriate.*

## 4120A. Trading Halts

## (a) Authority to Initiate Halts In Trading on the Alternative Display Facility

*NASD, pursuant to the procedures set forth in paragraph (b):*

(1) shall halt trading otherwise than on an exchange in the Alternative Display Facility in an ADF-eligible security whenever any market eligible to trade that security imposes a trading halt, or suspends the listing, to:

(A) permit dissemination of material news;

(B) obtain information from the issuer relating to material news;

(C) obtain information relating to the issuer's ability to meet listing qualification requirements; or

(D) obtain any other information that is necessary to protect investors and the public interest.

(2) shall close NASD Alternative Display Facility to quotation activity whenever NASD's Alternative Display Facility is unable to transmit real-time quotation or trade reporting information to the applicable Securities Information Processor. If ADF closes trading pursuant to this subparagraph (2), members would not be prohibited from trading through other markets for which trading is not halted.

Members shall promptly notify NASD whenever they have knowledge of any matter related to a security or the issuer thereof that has not been adequately disclosed to the public or where they have knowledge of a regulatory problem relating to such security.

## (b) Commencement and Termination of a Trading Halt

(1) In the event NASD determines that a basis exists under Rule 4120A(a) to initiate a trading halt, the commencement of the trading halt will be effective simultaneously with appropriate notice via an administrative message.

(2) Trading in a halted security shall resume upon notice via an administrative message that a trading halt is no longer in effect.

## 4200A. DEFINITIONS

(a) Unless the context requires otherwise, the terms used in the Rule 4000A and Rule 6000A Series shall have the meanings below. Terms not specifically defined below shall have the meaning in NASD's By-Laws and Rules and SEC Rule 11Aa3-1.

(1) "Act" means the Securities Exchange Act of 1934.

(2) "ADF-eligible security" means a Nasdaq National Market, Nasdaq SmallCap Market security and Nasdaq Convertible Debt securities.

(3) "Nasdaq" means the facilities operated by The Nasdaq Stock Market, Inc.

(4) "Nasdaq market maker" shall have the meaning as defined in Rule 4200.

(5) "Nasdaq National Market" or "NNM" is a distinct tier of the Nasdaq Stock Market comprised of securities that meet the requirements of and are authorized as a Nasdaq National Market Security.

(6) "Nasdaq security" means a security that is listed on Nasdaq.

(7) "Nasdaq SmallCap Market" or "SCM" is a distinct tier of The Nasdaq Stock Market comprised of securities that meet the requirements of and are authorized as a Nasdaq SmallCap Security.

(8) "Normal unit of trading" means 100 shares of a security unless, with respect to a particular security, the market where the security is listed determines that a normal unit of trading shall constitute other than 100 shares. If a normal unit of trading is other than 100 shares, a special identifier shall be appended to the issuer's symbol.

(9) "Registered Reporting ADF ECN" means a member of NASD that is an electronic communications network ("ECN") that elects to display orders in NASD's Alternative Display Facility. A member is a Registered Reporting ADF ECN in only those designated securities for which it is registered with NASD. A member shall cease being a Registered Reporting ADF ECN in a designated security when it has withdrawn or voluntarily terminated its quotations in that security on the ADF or when its quotations have been suspended or terminated by action of NASD. This term also shall include an NASD member that is an alternative trading system ("ATS") that displays orders in NASD's Alternative Display Facility.

(10) "Registered Reporting ADF Market Maker" means a member of NASD that is registered as an NASD market maker in a particular designated security and, with respect to that security, holds itself out (by entering quotations in NASD's Alternative Display Facility) as being willing to buy and sell such security for its own account on a regular and continuous basis. A member is a Registered Reporting ADF Market Maker in only those designated securities for which it is registered as an ADF market maker. A member shall cease being a Registered Reporting ADF Market Maker in a designated security when it has withdrawn or voluntarily terminated its quotations in that security on the ADF or when its quotations have been

suspended or terminated by action of NASD.

(11) "SEC Rule 100," "SEC Rule 101," "SEC Rule 103," and "SEC Rule 104" mean the rules adopted by the Commission under Regulation M, and any amendments thereto.

(12) "Stabilizing bid" means the terms "stabilizing" or to "stabilize" as defined in SEC Rule 100.

(13) "Underwriting Activity Report" is a report provided by the Market Regulation Department of NASD in connection with a distribution of securities subject to SEC Rule 101 pursuant to NASD Rule 2710(b)(11) and includes forms that are submitted by members to comply with their notification obligations under Rules 4614A, 4619A, and 4623A.

(b) For purposes of Rules 4619A, and 4623A, the following terms shall have the meanings as defined in SEC Rule 100: "affiliated purchaser," "distribution," "distribution participant," "independent bid," "net purchases," "passive market maker," "penalty bid," "reference security," "restricted period," "subject security," and "syndicate covering transaction."

#### 4300A. Quote and Order Access Requirements

(a) To ensure that NASD Market Participants comply with their quote and order access obligations as defined below, for each security in which they elect to display a bid and offer (for Registered Reporting ADF Market Makers), or a bid and/or offer (for Registered Reporting ADF ECNs), in the Alternative Display Facility, NASD Market Participants must:

(1) Provide other NASD Market Participants direct electronic access, as defined below; and

(2) Provide NASD member broker-dealers that are not NASD Market Participants direct electronic access, if requested, and allow for indirect electronic access, as defined below. In any event, an NASD Market Participant is prohibited from (A) in any way directly or indirectly influencing or prescribing the prices that their customer broker-dealer may choose to impose for providing indirect access; and (B) precluding or discouraging indirect electronic access, including through the imposition of discriminatory pricing or quality of service with regard to a broker-dealer that is providing indirect electronic access.

(3) Market Participants shall share equally the costs of providing to each other the direct electronic access required pursuant to paragraph (a)(1),

unless those Market Participants agree upon another cost-sharing arrangement.

(b) Subject to the terms and conditions contained herein, all NASD Market Participants that display quotations in NASD's Alternative Display Facility must record each item of information described in paragraphs (b)(1) and (2) of this Rule for all orders they receive from another broker-dealer via direct or indirect electronic access, and report this information to NASD as specified below.

(1) NASD Market Participants must record the following information for every order they receive from another broker-dealer via direct or indirect electronic access during the trading day:

- (A) Unique Order Identifier
- (B) Order Entry Firm (OEID)
- (C) Order Side (Buy/Sell)
- (D) Order Quantity
- (E) Issue Identifier
- (F) Order Price
- (G) Order Negotiable Flag
- (H) Time In Force (i.e. regular hours, entire day, other)
- (I) Order Date
- (J) Order Time (including seconds)
- (K) Minimal Acceptable Quantity (i.e. ANY, all or none (AON), volume)
- (L) Market Making Firm (MMID)
- (M) Trade-or-Move Flag

The information described in paragraphs (A) through (M) must be reported to NASD within 10 seconds of receipt of the order.

(2) In addition to the information previously provided pursuant to paragraph (b)(1), NASD Market Participants must record the following information, as applicable, for every order received via direct or indirect access from another broker-dealer that has been acted upon or responded to:

- (A) Unique Order Identifier (as provided in paragraph (b)(1)(A))
- (B) Order Response (i.e. E=Execute, D=Decline, X=Cancel, T=timed out, P=partial, I=Price improvement)
- (C) Order Response Time (including seconds)
- (D) Quantity
- (E) Price

The information described in paragraphs (A) through (E) must be reported to NASD within 10 seconds of any response to or action taken regarding an order. In the event that a member receives and executes an order within 10 seconds, the member may submit a single report that contains the information required in (b)(1) and (b)(2).

(3) Maintaining and Preserving Records

(A) In addition to submitting the information described herein to NASD, each member shall maintain and preserve records of the information

required to be recorded under this Rule for the period of time and accessibility specified in SEC Rule 17a-4(b).

(B) The records required to be maintained and preserved under this Rule may be immediately produced or reproduced on "micrographic media" as defined in SEC Rule 17a-4(f)(1)(i) or by means of "electronic storage media" as defined in SEC Rule 17a-4(f)(1)(ii) that meet the conditions set forth in SEC Rule 17a-4(f) and may be maintained and preserved for the required time in that form.

(4) Orders Not Required To Be Recorded

The recording and reporting requirements contained in paragraphs (a) and (b) of this Rule shall not apply to orders received via ITS or any system operated by a national securities exchange or national securities association.

(5) Method of Transmitting Data

Members shall transmit this information in such form as prescribed by NASD.

(6) Reporting Agent Agreements

(A) "Reporting Agent" shall mean a third party that enters into any agreement with a member pursuant to which such third party agrees to fulfill such member's obligations under this Rule.

(B) Any member may enter into an agreement with a Reporting Agent pursuant to which the Reporting Agent agrees to fulfill the obligations of such member under this Rule. Any such agreement shall be evidenced in writing, which shall specify the respective functions and responsibilities of each party to the agreement that are required to effect full compliance with the requirements of this Rule.

(C) All written documents evidencing an agreement described in paragraph (6)(B) shall be maintained by each party to the agreement.

(D) Each member remains responsible for compliance with the requirements of this Rule, notwithstanding the existence of an agreement described in this paragraph.

(7) Withdrawal of Quotations

If an NASD Market Participant knows or has reason to believe that it or its Reporting Agent is not complying with the requirements of this Rule, the member must withdraw its quotations from NASD's Alternative Display Facility until such time that the member is satisfied that its order information is being properly recorded and reported.

(c) NASD Market Participants are required to specify as part of their

NASD Alternative Display Facility Workstation Subscriber Agreement the method and terms by which they will comply with the requirements of this Rule. NASD staff will not approve a Market Participant's Subscriber Agreement unless the method and terms provided by the Market Participant are in compliance with this Rule.

(d) Definitions

(1) "Customer broker-dealer" is any broker-dealer that has, or seeks to have, an ongoing relationship with a Market Participant, including an ECN subscriber, for the purposes of executing securities transactions.

(2) "Direct electronic access" means the ability to deliver an order for execution directly against an individual NASD Market Participant's best bid and offer subject to quote and order access obligations, as defined herein, without the need for voice communication, with the equivalent speed, reliability, availability, and cost (as permissible under the federal securities laws, the rules and regulations thereunder, and the NASD Rules), as are made available to NASD Market Participant's own customer broker-dealers or other active customers or subscribers.

(3) "Indirect electronic access" means the ability to route an order through customer broker-dealers of an NASD Market Participant that are not affiliates of NASD Market Participant, for execution against NASD Market Participant's best bid and offer subject to quote and order access obligations, without the need for voice communication, with equivalent speed, reliability, availability, and cost, as are made available to the Market Participant's customer broker-dealer providing the indirect access or other active customers or subscribers. NASD Market Participant's customer broker-dealers providing indirect electronic access shall remain responsible for all orders routed through them as though the orders were the firms' own orders.

(4) "NASD Market Participant" means (a) an NASD ADF Registered Reporting Market Maker, (b) an ATS, (c) or an NASD ADF Registered ECN.

(5) "Best bid and offer" for purposes of this Rule includes the best-priced buy and sell orders of an NASD Market Participant.

(6) "Quote and Order Access Obligations" include the requirements under this Rule, the firm quote obligations under Rule 11Ac1-1 under the Act, and for ADF Registered ECNs, the standards under Rule 11Ac1-1(c)(5)(ii)(A)(2) under the Act, Sections 301(b)(3) through (5) of Regulation ATS and other order access-related regulatory requirements for ATSS, ECNs

and market makers. Obligations under this Rule include providing the ability to send or receive Trade-or-Move messages, identifiable as such, as required by Rule 4613A(d) and providing access to any reserved size orders as required by Rule 4623A(c).

(e) Minimum Performance Standards

(1) Direct electronic access provided by a Market Participant must allow the Market Participant the technological ability to respond to an order in two seconds or less. The two-second standard shall be measured from the time an order is received from the broker-dealer sending the order to the time an execution report or notice to decline the order is sent from the Market Participant to the broker-dealer that sent the order. With respect to orders received from other Market Participants, Market Participants must have in place a system that can accomplish turnaround of an order in three or fewer seconds, measured from the time an order is released by a Market Participant until the time an execution report is received by the Market Participant that placed the order. As a precondition to becoming a registered member of NASD Alternative Display Facility, Market Participants must certify to NASD their compliance with this paragraph based on reasonable forecasts of peak volume activity.

(2) In the event that a Market Participant experiences three (3) unexcused system outages during a period of five (5) business days, the Market Participant shall be suspended from quoting in NASD's Alternative Display Facility in all issues for a period of twenty (20) business days. For the purposes of this paragraph, a "system outage" shall mean an inability to post quotations in NASD's Alternative Display Facility or an inability to respond to orders.

(3) Officers of NASD or its subsidiaries designated by the Chief Executive Officer of NASD shall, pursuant to the procedures set forth in paragraph (f) below, have the authority to review any system outage to determine whether the system outage should be excused. An officer may deem a system outage excused upon proof by the Market Participant that the system outage resulted from circumstances not within the control of the Market Participant. The burden shall rest with the Market Participant to demonstrate that a system outage should be excused.

(4) A Market Participant may contact NASD Alternative Display Facility Operations and request that a system outage be deemed excused, whether or not the system outage resulted from



circumstances within the control of the Market Participant; however, if NASD Alternative Display Facility Operations becomes aware of the system outage prior to the Market Participant's request for an excused system outage, NASD Alternative Display Facility Operations may, at its own discretion, deem the system outage to be unexcused, based on the specific facts and circumstances surrounding the outage. In any event, a Market Participant shall be granted no more than five (5) excused system outages within 30 calendar days.

(f) Procedures for Reviewing System Outages

(1) Any Market Participant that seeks to have a system outage reviewed pursuant to paragraph (e)(3) hereof, shall submit a written request, via facsimile or otherwise, to NASD Alternative Display Facility Operations by close of the business day on which the system outage occurs, or the following business day if the system outage occurs outside of normal market hours.

(2) A Market Participant that seeks review of a system outage shall supply any supporting information for a determination under paragraph (e)(3) to NASD staff by the close of business on the day following the system outage.

(3) A Market Participant that seeks review of a system outage shall supply NASD staff with any information requested to make a determination pursuant to paragraph (e)(3).

(4) An officer shall, in accordance with paragraph (e)(3), make a determination whether a system outage is excused by the close of business on the day following the receipt of information supplied pursuant to paragraphs (f)(2) and (f)(3).

(5) A Market Participant may appeal a determination made under paragraph (e)(3) to NASD's Alternative Display Facility Market Operations Review Committee in writing, via facsimile or otherwise, by the close of business on the day a determination is rendered pursuant to paragraph (e)(3). An appeal to the Committee shall operate as a stay of the determination made pursuant to paragraph (e)(3). Once a written appeal has been received, the Market Participant may submit any additional supporting written documentation, via facsimile or otherwise, up until the time the appeal is considered by the Committee. The Committee shall render a determination by the close of business following the day a notice of appeal is received. The Committee's determination shall be final and binding.

4600A. TRADING IN NASDAQ SECURITIES

4610A. Registration and Other Requirements

4611A. Registration as an ADF Market Maker

(a) Quotations and quotation sizes in Nasdaq securities may be entered into NASD's Alternative Display Facility only by a Registered Reporting ADF Market Maker or other entity approved by NASD to function in a market-making capacity.

(b) An NASD member seeking registration as a market maker in the ADF shall file an application with NASD. The application shall certify the member's good standing with NASD and shall demonstrate compliance with the net capital and other financial responsibility provisions of the Act. It shall be sufficient to obtain registration as a market maker for a member to demonstrate proof that it is a registered Nasdaq market maker in good standing. A member's registration as an ADF market maker shall become effective upon receipt by the member of notice of approval of registration from NASD.

(c) A registered reporting ADF market maker may become registered in an issue by entering a registration request via an NASD terminal or other NASD approved electronic interface with NASD's systems or by contacting NASD Alternative Display Facility Operations. If the requirements of paragraph (b) above are satisfied, registration shall become effective on the day the registration request is entered. It shall be sufficient to obtain registration in an issue for a member to demonstrate proof that it is currently registered in that issue as a Registered Reporting Nasdaq market maker and is in good standing.

(d) A market maker's registration in an issue shall be terminated if the market maker fails to enter quotations in the issue within five (5) business days after the market maker's registration in the issue becomes effective.

4612A. Reserved

4613A. Character of Quotations

(a) Two-Sided Quotations

(1) For each Nasdaq security for which a member is a Registered Reporting ADF Market Maker, the member shall be willing to buy and sell such security for its own account on a continuous basis and shall enter and maintain two-sided quotations through NASD's Alternative Display Facility, subject to the procedures for excused withdrawal set forth in Rule 4619A.

(A) A Registered Reporting ADF Market Maker in a security listed on

Nasdaq must display a quotation size for at least one normal unit of trading (or a larger multiple thereof) when it is not displaying a limit order in compliance with SEC Rule 11Ac1-4, provided, however, that a Registered Reporting ADF Market Maker may augment its displayed quotation size to display limit orders priced at the market maker's quotation.

(B) Minimum Price Variation for Decimal-based Quotations

The minimum quotation increment for securities authorized for decimal pricing as part of the SEC-approved Decimals Implementation Plan for the Equities and Options Markets shall be \$0.01. Quotations failing to meet this standard shall be rejected.

(b) Firm Quotations

(1) A Registered Reporting ADF Market Maker that receives an offer to buy or sell from another NASD member shall execute a transaction for at least a normal unit of trading at its displayed quotations as disseminated through NASD's Alternative Display Facility at the time of receipt of any such offer. If a Registered Reporting ADF Market Maker displays a quotation for a size greater than a normal unit of trading, it shall, upon receipt of an offer to buy or sell from another NASD member, execute a transaction at least at the size displayed.

(2) If a Registered Reporting ADF Market Maker, upon receipt of an offer to buy or sell from another NASD member in any amount that is at least one normal unit of trading greater than its published quotation size as disseminated through NASD's Alternative Display Facility at the time of receipt of any such offer, executes a transaction in an amount of shares less than the size of the offer, then such Registered Reporting ADF Market Maker shall, immediately after such execution, display a revised quotation at a price that is inferior to its previous published quotation. The failure of a Registered Reporting ADF Market Maker to execute the offer in an amount greater than its published quotation size shall not constitute a violation of subparagraph (b)(1) of this rule.

(c) Quotations Reasonably Related to the Market

A Registered Reporting ADF Market Maker shall enter and maintain quotations that are reasonably related to the prevailing market. In the event it appears that a Registered Reporting ADF Market Maker's quotations are no longer reasonably related to the prevailing market, NASD may require



the market maker to re-enter its quotations. If a Registered Reporting ADF Market Maker whose quotations are no longer reasonably related to the prevailing market fails to re-enter its quotations, NASD may suspend the market maker's quotations in one or all securities.

(1) In the event that a Registered Reporting ADF Market Maker's ability to enter or update quotations is impaired, the Registered Reporting ADF Market Maker shall immediately contact NASD Alternative Display Facility Operations to request the withdrawal of its quotations.

(2) In the event that a Registered Reporting ADF Market Maker's ability to enter or update quotations is impaired and the Registered Reporting ADF Market Maker elects to continue to participate through NASD's Alternative Display Facility, the Registered Reporting ADF Market Maker shall execute an offer to buy or sell received from another NASD member at its quotations as disseminated through NASD's Alternative Display Facility.

**(d) Locked and Crossed Markets**

(1) A Registered Reporting ADF Market Maker shall not, except under extraordinary circumstances, enter or maintain quotations through NASD's Alternative Display Facility during normal business hours if:

(A) the bid quotation entered is equal to ("lock") or greater than ("cross") the asked quotation of another market maker entering quotations in the same security; or

(B) the asked quotation is equal to ("lock") or less than ("cross") the bid quotation of another market maker entering quotations in the same security.

**(2) Obligations Regarding Locked/Crossed Market Conditions Prior to Market Opening**

(A) **Locked/Crossed Market Prior to 9:20 a.m.**—For locks/crosses that occur prior to 9:20 a.m. Eastern Time, a Registered Reporting ADF Market Maker that is a party to a lock/cross because the Registered Reporting ADF Market Maker either has entered a bid (ask) quotation that locks/crosses another market maker's quotation(s) or has had its quotation(s) locked/crossed by another market maker ("party to a lock/cross") may, beginning at 9:20 a.m. Eastern Time, send a message, making use of direct electronic access in accordance with Rule 4300, of any size, that is at the receiving market maker's quoted price ("Trade-or-Move Message"). Any Registered Reporting ADF Market Maker that receives a Trade-or-Move Message at or after 9:20

a.m. Eastern Time, and that is a party to a lock/cross, must within 30 seconds of receiving such message either: fill the incoming Trade-or-Move Message for the full size of the message; or move its bid down (offer up) by a quotation increment that unlocks/uncrosses the market.

(B) **Locked/Crossed Market Between 9:20 and 9:29:59 a.m.**

(i) Before a Registered Reporting ADF ECN enters a quote that would lock or cross the market between 9:20 and 9:29:29 a.m. Eastern Time, the ECN must first send, making use of direct electronic access in accordance with Rule 4300, to the market maker or ECN whose quote it would lock or cross a Trade-or-Move Message that is at or superior to the receiving market maker's or ECN's quoted price. An ECN that sends a Trade-or-Move Message during these periods must then wait at least 10 seconds before entering a quote that would lock or cross the market

(ii) If a Registered Reporting ADF Market Maker locks or crosses the market between 9:20 and 9:29:29 a.m. Eastern Time, the Registered Market Maker must then immediately send, making use of direct electronic access in accordance with Rule 4300, to the market maker whose quotes it is locking or crossing a Trade-or-Move message that is at the receiving market maker's or ECN's quoted price.

(iii) Market participants shall be prohibited from entering a quote that would lock or cross the market between 9:29:30 and 9:29:59.

(C)(i) In the case of securities included in the Nasdaq 100 Index or the S&P 400 Index, a Trade-or-Move Message must be for at least 10,000 shares (in instances where there are multiple market makers to a lock/cross, the locking/crossing market maker must send a message to each party to the lock/cross and the aggregate size of all such messages must be at least 10,000 shares); provided, however, that if a market participant is representing an agency order, the market participant shall be required to send a Trade-or-Move Message(s) in an amount equal to the agency order, even if that order is less than 10,000 shares.

(ii) In the case of all other securities, a Trade-or-Move Message must be for at least 5,000 shares (if multiple market makers would be locked/crossed, each one must receive a Trade-or-Move Message and the aggregate size of all such messages must be at least 5,000 shares); provided, however, that if a market participant is representing an agency order, the market participant shall be required to send a Trade-or-Move Message(s) in an amount equal to

the agency order, even if that order is less than 5,000 shares.

(D) A market maker that receives a Trade-or-Move Message must, within 10 seconds of receiving such message, either fill the incoming Trade-or-Move Message for the full size of the message, or move its bid down (offer up) by a quotation increment that restores or maintains an unlocked/uncrossed market.

(E) A Registered Reporting ADF Market Maker that sends a Trade-or-Move Message pursuant to this rule must append to the message a symbol indicating that it is a Trade-or-Move Message.

(F) For the purposes of this rule "agency order" shall mean an order(s) that is for the benefit of the account of a natural person executing securities transactions with or through or receiving investment banking services from a broker/dealer, or for the benefit of an "institutional account" as defined in NASD Rule 3110. An agency order shall not include an order(s) that is for the benefit of a market maker in the security at issue, but shall include an order(s) that is for the benefit of a broker/dealer that is not a market maker in the security at issue.

**(3) Obligations Regarding Locked/Crossed Market Conditions During Market Hours**

A Registered Reporting ADF Market Maker, prior to entering a quotation that locks or crosses another quotation, must make reasonable efforts to avoid such locked or crossed market by executing transactions with all market makers whose quotations would be locked or crossed. Reasonable efforts shall include making use of direct electronic access in accordance with Rule 4300A. Pursuant to the provisions of paragraph (b) of this Rule, a Registered Reporting ADF Market Maker whose quotations are causing a locked or crossed market is required to execute transactions at its quotations as displayed through NASD's Alternative Display Facility at the time of receipt of any order.

(4) Except as indicated in subsection (2)(B), for purposes of this Rule 4613A(d), the term "Registered Reporting ADF Market Maker" shall include:

(A) any NASD member that enters into an ECN, as that term is defined in SEC Rule 11Ac1-1(a)(8), an order that is displayed through NASD's Alternative Display Facility;

(B) any NASD member that operates the ECN when the order being displayed has been entered by a person or entity that is not an NASD member;

(C) any NASD member that enters into an ATS, as that term is defined in SEC Regulation ATS, a priced order that is displayed through NASD's Alternative Display Facility; and

(D) any NASD member that operates the ATS when the priced order being displayed has been entered by a person or entity that is not an NASD member.

(e) Other Quotation Obligations

(1) Members that display priced quotations on a real-time basis for Nasdaq securities in two or more market centers that permit quotation updates on a real-time basis must display the same priced quotations for the security in each market center.

(2) A member that is registered as a market maker in a Nasdaq security shall be obligated to have available in close proximity to NASD's Alternative Display Facility terminal at which it makes a market in a Nasdaq security a quotation service that disseminates the bid price and offer price then being furnished by or on behalf of other market makers trading and quoting that Nasdaq security.

#### IM-4613A. Autoquote Policy

(a) General Prohibition—NASD bans the automated update of quotations by market makers through NASD's Alternative Display Facility. Except as provided below, this policy prohibits systems known as "autoquote" systems from effecting automated quote updates or tracking of inside quotations through NASD's Alternative Display Facility. This ban is necessary to offset the negative impact on the capacity and operation of NASD's Alternative Display Facility that may be caused by certain autoquote techniques that track changes to the inside quotation and automatically react by generating another quote to keep the market maker's quote away from the best market.

(b) Exceptions to the General Prohibition—Automated updating of quotations is permitted when: (1) the update is in response to an execution in the security by that firm (such as execution of an order that partially fills a market maker's quotation size), and is in compliance with Rule 4613A(b)(2); (2) it requires a physical entry (such as a manual entry to the market maker's internal system which then automatically forwards the update to Nasdaq); or (3) the update is to reflect the receipt, execution, or cancellation of a customer limit order.

4614A. Reserved

4615A. Reserved

4616A. Reserved

4617A. Normal Business Hours

A Registered Reporting ADF Market Maker shall be open for business as of 9:30 a.m. Eastern Time and shall close no earlier than 4:00 p.m. Eastern Time. A Registered Reporting ADF Market Maker may remain open for business on a voluntary basis for any period of time between 4:00 p.m. Eastern time and 6:30 p.m. Eastern Time. Registered Reporting ADF Market Makers whose quotes are open after 4:00 p.m. Eastern Time shall be obligated to comply, while their quotes are open, with all NASD Rules that are not by their express terms, or by an official interpretation of NASD, inapplicable to any part of the 4:00 p.m. to 6:30 p.m. Eastern Time period.

4618A. Clearance and Settlement

(a) A market maker shall clear and settle transactions effected on the ADF in Nasdaq securities that are eligible for net settlement through the facilities of a registered clearing agency that uses a continuous net settlement system. This requirement may be satisfied by direct participation, use of direct clearing services, or by entry into a correspondent clearing arrangement with another member that clears trades through such an agency.

(b) Notwithstanding paragraph (a), transactions in Nasdaq securities may be settled "ex-clearing" provided that both parties to the transaction agree.

4619A. Withdrawal of Quotations and Passive Market Making

(a) A Registered Reporting ADF Market Maker that wishes to withdraw quotations in a security or have its quotations identified as the quotations of a passive market maker shall contact NASD Alternative Display Facility Operations to obtain excused withdrawal status prior to withdrawing its quotations or identification as a passive market maker. If a Registered Reporting ADF Market Maker also is a Registered Reporting Nasdaq Market Maker, it must obtain excused withdrawal status in both facilities for the same time period. Withdrawals of quotations or identifications of quotations as those of a passive market maker shall be granted by NASD Alternative Display Facility Operations only upon satisfying one of the conditions specified in this Rule.

(b) Excused withdrawal status based on circumstances beyond the market maker's control may be granted for up to five (5) business days, unless

extended by NASD Alternative Display Facility Operations. Excused withdrawal status based on demonstrated legal or regulatory requirements, supported by appropriate documentation and accompanied by a representation that the condition necessitating the withdrawal of quotations is not permanent in nature, may, upon notification, be granted for not more than sixty (60) days (unless such request is required to be made pursuant to paragraph (d) below). Excused withdrawal status based on religious holidays may be granted only if notice is received by NASD one business day in advance and is approved by NASD. Excused withdrawal status based on vacation may be granted only if:

(1) the request for withdrawal is received by NASD one business day in advance, and is approved by NASD; and

(2) the request includes a list of the securities for which withdrawal is requested.

(c) Excused withdrawal status may be granted to a Registered Reporting ADF Market Maker that has withdrawn from an issue prior to the public announcement of a merger or acquisition and wishes to re-register in the issue pursuant to the same-day registration procedures contained in Rule 4611A, above, provided the Registered Reporting ADF Market Maker has remained registered in one of the affected issues. The withdrawal of quotations because of pending news, a sudden influx of orders or price changes, or to effect transactions with competitors shall not constitute acceptable reasons for granting excused withdrawal status.

(d) Excused withdrawal status may be granted to a member that experiences a documented problem or failure impacting the operation or utilization of any automated system operated by or on behalf of the firm (chronic system failures within the control of the member will not constitute a problem or failure impacting a firm's automated system).

(e) Excused withdrawal status may be granted to a Registered Reporting ADF Market Maker that fails to maintain a clearing arrangement with a registered clearing agency or with a member of such an agency, thereby terminating its registration as a Registered Reporting ADF Market Maker; provided however, that if NASD finds that the Registered Reporting ADF Market Maker's failure to maintain a clearing arrangement is voluntary, the withdrawal of quotations will be considered voluntary and unexcused pursuant to Rule 4620A.

(f) Excused withdrawal status or passive market maker status may be

granted to a Registered Reporting ADF Market Maker that is a distribution participant (or, in the case of excused withdrawal status, an affiliated purchaser) in order to comply with SEC Rules 101, 103, or 104 under the Act on the following conditions:

(1) A member acting as a manager (or in a similar capacity) of a distribution of a security that is a subject security or reference security under Rule 101 and any member that is a distribution participant or an affiliated purchaser in such a distribution that does not have a manager shall provide written notice to NASD Alternative Display Facility Operations and the Market Regulation Department of NASD no later than the business day prior to the first entire trading session of the one-day or five-day restricted period under SEC Rule 101, unless later notification is necessary under the specific circumstances.

(A) The notice required by subparagraph (f)(1) of this Rule shall be provided by submitting a completed Underwriting Activity Report that includes a request on behalf of each market maker that is a distribution participant or an affiliated purchaser to withdraw the market maker's quotations, or that includes a request on behalf of each market maker that is a distribution participant (or an affiliated purchaser of a distribution participant) that its quotations be identified as those of a passive market maker and includes the contemplated date and time of the commencement of the restricted period.

(B) The managing underwriter shall advise each Registered Reporting ADF Market Maker that it has been identified as a distribution participant or an affiliated purchaser to NASD Alternative Display Facility Operations and that its quotations will be automatically withdrawn or identified as passive market maker quotations, unless a market maker that is a distribution participant (or an affiliated purchaser of a distribution participant) notifies NASD Alternative Display Facility Operations as required by subparagraph (f)(2), below.

(2) A Registered Reporting ADF Market Maker that has been identified to NASD Alternative Display Facility Operations as a distribution participant (or an affiliated purchaser of a distribution participant) shall promptly notify NASD Alternative Display Facility Operations and the manager of its intention not to participate in the prospective distribution or not to act as a passive market maker in order to avoid having its quotations withdrawn or identified as the quotations of a passive market maker.

(3) If a Registered Reporting ADF Market Maker that is a distribution participant withdraws its quotations in a Nasdaq security in order to comply with the net purchases limitation of SEC Rule 103 or with any other provision of SEC Rules 101, 103, or 104 and promptly notifies NASD Alternative Display Facility Operations of its action, the withdrawal shall be deemed an excused withdrawal. Nothing in this subparagraph shall prohibit NASD from taking such action as is necessary under the circumstances against a member and its associated persons for failure to contact NASD Alternative Display Facility Operations to obtain an excused withdrawal as required by subparagraph (a) of this Rule.

(4) The quotations of a passive market maker shall be identified on NASD Alternative Display Facility Data Systems as those of a passive market maker.

(5) A member acting as a manager (or in a similar capacity) of a distribution subject to subparagraph (f)(1) of this Rule shall submit a request to NASD Alternative Display Facility Operations and the Market Regulation Department of NASD to rescind the excused withdrawal status or passive market making status of distribution participants and affiliated purchasers, which request shall include the date and time of the pricing of the offering, the offering price, and the time the offering terminated, and, if not in writing, shall be confirmed in writing no later than the close of business the day the offering terminates. The request referenced in this subparagraph may be resubmitted on the Underwriting Activity Report.

(g) NASD's Alternative Display Facility Operations Review Committee shall have jurisdiction over proceedings brought by market makers seeking review of a denial of an excused withdrawal pursuant to this Rule, or the conditions imposed on their reentry.

#### 4620A. Voluntary Termination of Registration

A Registered Reporting ADF Market Maker may voluntarily terminate its registration in a security by (1) withdrawing its quotations from NASD's Alternative Display Facility and not re-entering its quotations for five (5) minutes, or (2) failing to re-enter quotations within thirty (30) minutes of the end of a trading halt. A Registered Reporting ADF Market Maker that voluntarily terminates its registration in a security may not re-register as a market maker in that security for twenty (20) business days, absent an excused withdrawal specified in Rule 4619A.

Withdrawal from participation as a Registered Reporting ADF Market Maker in NASD's Alternative Display Facility shall constitute termination of registration as a market maker in that security for purposes of this Rule; provided, however, that a Registered Reporting ADF Market Maker that fails to maintain a clearing arrangement with a registered clearing agency or with a member of such an agency and thereby terminates its registration as a market maker in Nasdaq securities may register as a market maker at any time after a clearing arrangement has been reestablished.

#### 4621A. Suspension and Termination of Quotations by NASD Action

NASD may, pursuant to the procedures set forth in the Rule 9000 Series, suspend, condition, limit, prohibit or terminate a Registered Reporting ADF Market Maker's authority to enter quotations in one or more authorized securities for violations of applicable requirements or prohibitions.

#### 4622A. Termination of NASD Alternative Display Facility Data System Service

NASD may, upon notice, terminate NASD Alternative Display Facility Data System service in the event that a Registered Reporting ADF Market Maker fails to qualify under specified standards of eligibility or fails to pay promptly for services rendered by NASD.

#### 4623A. Alternative Trading Systems

(a) NASD may provide a means to permit alternative trading systems ("ATSS"), as such term is defined in Regulation ATS, and electronic communications networks ("ECNs"), as such term is defined in SEC Rule 11Ac1-1(a)(8), to comply with the display requirements of SEC Rule 301(b)(3) and the terms of the ECN display alternative provided for in SEC Rule 11Ac1-1(c)(5)(ii)(A) and (B) ("ECN display alternatives"). NASD will not facilitate compliance with access requirements, which are the responsibility of Market Participants under Rule 4300A.

(b) An ATS or ECN that seeks to use NASD-provided means to comply with SEC Rule 301(b)(3) and/or the ECN display alternatives shall:

(1) demonstrate to NASD that it is in compliance with Regulation ATS or that it qualifies as an ECN meeting the definition in the SEC Rule;

(2) be registered as an NASD member;

(3) enter into and comply with the terms of an NASD Alternative Display

Facility Workstation Subscriber Agreement, as amended for ATSS and ECNs;

(4) agree to provide for NASD's dissemination in the quotation data made available to quotation vendors the prices and sizes of NASD Registered Market Maker orders (and orders from other subscribers of the ATS or ECN, if the ATS or ECN so chooses or is required by SEC Rule 301(b)(3) to display a subscriber's order in NASD's Alternative Display Facility), at the highest buy price and the lowest sell price for each Nasdaq security entered in and widely disseminated by the ATS or ECN; and prior to entering such prices and sizes, register with NASD Alternative Display Facility Operations as an ATS or ECN; and

(5) comply with Rule 4300A.

(c) When an NASD member attempts to access electronically an ATS or ECN-displayed order by sending an order that is larger than the ATS' or ECN's Nasdaq-displayed size and the ATS or ECN is displaying the order on a reserved size basis, the NASD member that operates the ATS or ECN shall execute such delivered order:

(1) up to the size of the delivered order, if the ATS or ECN order (including the reserved size and displayed portions) is the same size or larger than the delivered order; or

(2) up to the size of the ATS or ECN order (including the reserved size and displayed portions), if the delivered order is the same size or larger than the ATS or ECN order (including the reserved size and displayed portions).

No ATS or ECN operating through NASD's Alternative Display Facility pursuant to this Rule is permitted to provide a reserved-size function unless the size of the order displayed through NASD's Alternative Display Facility is 100 shares or greater. For purposes of this Rule, the term "reserved size" shall mean that a customer entering an order into an ATS or ECN has authorized the ATS or ECN to display publicly part of the full size of the customer's order with the remainder held in reserve on an undisplayed basis to be displayed in whole or in part as the displayed part is executed.

4624A. Reserved

4625A. Reserved

4630A. Reporting Transactions in Nasdaq Securities

This Rule 4630A Series governs the reporting by members of ADF-eligible securities through NASD's Trade Reporting and Comparison Service ("TRACS"). The Rule 5400 Series provides the rules for determining which

member must report a trade and whether a trade must be reported to TRACS pursuant to this Rule 4630A Series. Participation in the trade reporting function of TRACS is mandatory for all members that have a trade reporting obligation through TRACS under the Rule 5400 Series or that choose to report transactions through TRACS. Participation in the trade reporting function of TRACS is conditioned upon (a) execution of, and continuing compliance with, a TRACS trade reporting Participant Application Agreement and (b) maintenance of the physical security of the equipment on the premises of the member to prevent unauthorized entry of information into the trade reporting function of TRACS.

4631A. Reserved

4632A. Transactions Reported by Members

(a) When and How Transactions are Reported

Members shall comply with Rule 5430(a) for determining when and how transactions are reported.

(b) Which Party Reports Transaction

Members shall comply with Rule 5430(b) for determining which party reports a transaction.

(c) Information To Be Reported—Two Party Trade Reports

(1) A two party trade report is a last sale report that denotes a trade between one Reporting NASD member and one Non-Reporting Member. The Reporting NASD Member is denoted as the ("MMID") side of the trade report and the Non-Reporting Member is denoted as the ("OEID") side of the report.

(2) Each two party last sale report submitted by a reporting nasd member should contain:

(A) Security identification symbol (SECID);

(B) Number of shares or bonds;

(C) Price of the transaction as required by paragraph (h) below;

(D) A designated symbol denoting whether the transaction, from the Reporting NASD Member's perspective, is a buy, sell, sell short, sell short exempt, or cross;

(E) If known, a designated symbol denoting whether the transaction, from the perspective of the Non-Reporting Member, is a buy, sell, sell short, or sell short exempt;

(F) A designated symbol denoting whether the transaction, from the perspective of the Reporting Member, is a principal, riskless principal, or agent;

(G) If known, a designated symbol denoting whether the transaction, from

the perspective of the Non-Reporting Member, is a principal, riskless principal, or agent;

(H) For any transaction in an order for which a member has recording and reporting obligations under NASD Rules 6954 and 6955, the trade report must include:

(i) an order identifier, meeting such parameters as may be prescribed by NASD, assigned to the order that uniquely identifies the order for the date it was received (see Rule 6954(b)(1));

(ii) The time of execution. This information must be reported regardless of the period of time between execution of the trade and the NASD report.

(I) Execution time for any transaction not reported within 90 seconds of execution;

(J) The market participant identifier of the Reporting Member and the Non-Reporting Member;

(K) Reporting Member clearing broker;

(L) Reporting Member Executing Broker in case of a "give up;"

(M) Non-Reporting Member Executing Broker;

(N) Non-Reporting Member introducing broker in case of a "give up;"

(O) Non-Reporting Member clearing broker;

(P) A designated symbol denoting whether the trade report should be published;

(Q) A designated symbol denoting whether the trade report should be compared in TRACS;

(R) If the contra side to the trade report is a customer of the Reporting Member, the Reporting Member shall denote that the trade is an internalized trade with the designated symbol;

(S) If the contra side to the trade report is a Non-NASD member, the Reporting Member shall indicate with the designated symbol that the contra side is a non-member.

(T) For two party trade reports submitted pursuant to an Automated Give Up ("AGU") arrangement or a Qualified Service Representative ("QSR") Agreement, disclosure of the information set forth in subparagraphs (e)(2)(E) and (G) is mandatory.

(3)(A) In the event that the MMID side or the OEID side determines that any information provided pursuant to subparagraphs (e)(2)(D), (E), (F), (G), or (H)(i) is inaccurate or incomplete, the MMID side or OEID side, as applicable, must submit a trade report addendum within fifteen (15) minutes of the submission of the original trade report to correct or provide some or all of the following information:

(i) Short sale indicator;

(ii) Volume related to short sale indicator change;

(iii) Capacity Indicator;  
(iv) Volume related to capacity change; or

(v) Branch Sequence Number  
(B) The trade report addendum feature of TRACS may also be used by members to add or modify the User Assigned Reference Number.

(C) Each trade report addendum must contain the following information:

(i) Reference number for the original trade report that is being amended or modified;

(ii) OEID side or MMID side flag; and

(iii) MPID.

(d) Information To Be Reported—Three Party Trade Reports

(1) A three party trade report is a single last sale trade report that denotes one Reporting Member and two contra parties. The Reporting Member is denoted as the MMID side of the trade report and the two non-reporting sides are denoted as the OEID side of the trade report. In a three party report, the Reporting Member is the buyer to one OEID and the seller to the other OEID. Registered ECNs may submit three party trade reports. Riskless principal trades also may be submitted by reporting members as three party trade reports.

(2) Each Three Party Trade Report Submitted by a Reporting Member shall contain the following information:

Transaction Information

(A) Security Identification Symbol (SECID);

(B) Number of shares or bonds;

(C) Price of the transaction as required by paragraph (h) below;

(D) Execution time for any transaction not reported within 90 seconds of execution;

(E) The market participant identifier of the Reporting Member and the two Non-Reporting Members;

(F) A designated symbol denoting whether the trade should be published;

(G) For any transaction in an order for which a member has recording and reporting obligations under NASD Rules 6954 and 6955, the trade report must include:

(i) an order identifier, meeting such parameters as may be prescribed by NASD, assigned to the order that uniquely identifies the order for the date it was received (see Rule 6954(b)(1)). This order number must associate both the buy side and sell side OATS Execution Reports to the TRACS report;

(ii) The time of execution. This information must be reported regardless of the period of time between execution of the trade and the NASD report.

MMID Side

(H) All three party trade reports from ECNs must be marked as agency cross transactions;

(I) All three party trade reports from Non-ECNs must be denoted as riskless principal trade reports and shall include a designated symbol denoting whether the trade between the non-ECN and the buy-side OEID is a sell, sell short, or sell short exempt transaction;

(J) Reporting Member clearing broker;

(K) Reporting Member Executing Broker in the case of a "give up"; Buy Side OEID

(L) Buy Side OEID executing broker;

(M) Buy Side OEID introducing broker in case of a "give up";

(N) Buy Side OEID clearing broker;

(O) If known, a designated symbol denoting whether the trade, from the Buy Side OEID's perspective, is as principal, riskless principal, or agent;

(P) If the Buy Side OEID is a customer of the Reporting Member, the Reporting Member shall denote that the trade is an internalized trade with the designated symbol;

(Q) If the Buy Side OEID is a non-NASD member, the Reporting Member shall indicate with the designated symbol that the buy side OEID is a non-member;

(R) A designated symbol denoting whether the trade between the MMID and the Buy Side OEID shall be compared in TRACS;

Sell Side OEID

(S) Sell Side OEID executing broker;

(T) Sell Side OEID introducing broker in case of a "give up";

(U) Sell Side OEID clearing broker;

(V) If known, a designated symbol denoting whether the trade, from the Sell Side OEID's perspective, is as principal, riskless principal, or agent;

(W) If known, a symbol denoting whether the trade, from the Sell Side OEID's perspective, is a sell, sell short, or sell short exempt transaction;

(X) If the Sell Side OEID is a customer of the Reporting Member, the Reporting Member shall denote that the trade is an internalized trade with the designated symbol;

(Y) If the Sell Side OEID is a non-NASD Member, the Reporting Member shall indicate with the designated symbol that the buy side OEID is a non-member;

(Z) A designated symbol denoting whether the trade between the MMID and the Sell Side OEID shall be compared in TRACS;

(AA) If the transaction between the Buy Side OEID and the Reporting Member is reported pursuant to an AGU

arrangement or a QSR agreement, disclosure of the information set forth in subparagraph (f)(2)(O) is mandatory; and

(BB) If the transaction between the Sell Side OEID and the Reporting Member is reported pursuant to an AGU arrangement or a QSR agreement, disclosure of the information set forth in subparagraphs (f)(2)(V) and (W) is mandatory.

(3)(A) In the event that the MMID side or the OEID side determines that any information provided pursuant to subparagraphs (f)(2)(G)(i), (I), (O), (V), or (W) is inaccurate or incomplete, the MMID side or OEID side, as applicable, must submit a trade report addendum within fifteen (15) minutes of the submission of the original trade report to correct or provide some or all of the following information:

(i) Short sale indicator;

(ii) Volume related to short sale indicator change;

(iii) Capacity Indicator;

(iv) Volume related to capacity change; or

(v) Branch Sequence Number

(B) The trade report addendum feature of TRACS may also be used by members to add or modify the User Assigned Reference Number.

(C) Each trade report addendum must contain the following information:

(i) Reference number for the original trade report that is being amended or modified;

(ii) OEID side or MMID side flag; and

(iii) MPID.

(e) Procedures for Reporting Price and Volume

(1) Members that are required, or have the option, to report transactions pursuant to paragraph (d) above shall transmit last sale reports in the following manner:

(A) For agency transactions, report the number of shares (or bonds) and the price excluding the commission charged.

Example:

SELL as agent 100 shares at 40 less a commission of \$12.50;

REPORT 100 shares at 40.

(B) For dual agency transactions, report the number of shares (or bonds) only once, and report the price excluding the commission charged.

Example:

SELL as agent 100 shares at 40 less a commission of \$12.50;

BUY as agent 100 shares at 40 plus a commission of \$12.50;

REPORT 100 shares at 40.

(C)(i) For principal transactions, except as provided below, report each

purchase and sale transaction separately and report the number of shares (or bonds) and the price. For principal transactions that are executed at a price that includes a mark-up, mark-down or service charge, the price reported shall exclude the mark-up, mark-down or service charge. Such reported price shall be reasonably related to the prevailing market, taking into consideration all relevant circumstances including, but not limited to, market conditions with respect to the security, the number of shares (or bonds) involved in the transaction, the published bids and offers with size at the time of the execution (including the reporting firm's own quotation), the cost of execution and the expenses involved in clearing the transaction.

**Example:**

BUY as principal 100 shares from another member at 40 (no mark-down included);

REPORT 100 shares at 40.

**Example:**

BUY as principal 100 shares from a customer at 39.85 which includes a .15 mark-down from prevailing market at 40;

REPORT 100 shares at 40.

**Example:**

SELL as principal 100 shares to a customer at 40.15, which includes a .15 mark-up from the prevailing market of 40;

REPORT 100 shares at 40.

**Example:**

BUY as principal 10,000 shares from a customer at 39.75, which includes a .25 mark-down or service charge from the prevailing market of 40;

REPORT 10,000 shares at 40.

(ii) Exception: A "riskless" principal transaction in which a member after having received an order to buy a security, purchases the security as principal at the same price to satisfy the order to buy or, after having received an order to sell, sells the security as principal at the same price to satisfy the order to sell, shall be reported as one three party transaction, excluding the mark-up or mark-down, commission-equivalent, or other fee. Alternatively, a member may report a riskless principal transaction by submitting the following report(s) to NASD:

a. The member with the obligation to report the transaction pursuant to paragraph (d) above must submit a last sale report for the initial leg of the transaction.

b. Regardless of whether a member has a reporting obligation pursuant to

paragraph (d) above, the firm must submit, for the offsetting, "riskless" portion of the transaction, either:

1. a clearing-only report with a capacity indicator of "riskless principal," if a clearing report is necessary to clear the transaction; or

2. a non-tape, non-clearing report with a capacity indicator of "riskless principal," if a clearing report is not necessary to clear the transaction.

**Example:**

SELL as a principal 100 shares to another member at 40 to fill an existing order;

BUY as principal 100 shares from a customer at 40 minus a mark-down of \$12.50;

REPORT 100 shares at 40 by submitting to NASD either a single trade report marked with a "riskless principal" capacity indicator or by submitting the following reports:

3. where required by this Rule, a tape report marked with a "principal" capacity indicator; and

4. either a non-tape, non-clearing report or a clearing-only report marked with a "riskless principal" capacity indicator.

(D) For transactions that are executed at a price different from the current market when the execution is based on a prior reference point in time, members shall append to the transaction report a trade report modifier designated by NASD and shall include in the transaction report the prior reference time.

**Example:**

At 9:45 a.m., a member discovers that a customer's order to BUY 100 shares at the opening price has not been executed.

The member executes the customer's order at 9:45 a.m. at the opening price (40). Current market is 41.

REPORT 100 shares at 40 and append the .PRP modifier with the time 9:30.

**(f) Aggregation of Transaction Reports**

(1) Under the following conditions, individual executions of orders in a security at the same price may be aggregated, for transaction reporting purposes, into a single transaction report. Individual transactions in convertible debt securities cannot be aggregated pursuant to this paragraph.

(A) Orders received prior to the opening of the reporting member's market in the security and simultaneously executed at the opening. Also, orders received during a trading or quotation halt in the security and executed simultaneously when trading or quotations resume. In no event shall

a member delay its opening or resumption of quotations for the purpose of aggregating transactions.

**Example:**

A firm receives, prior to its market opening, several market orders to sell which total 10,000 shares. All such orders are simultaneously executed at the opening at a reported price of 40.

REPORT 10,000 shares at 40.

(B) Simultaneous executions by the member of customer transactions at the same price, e.g., a number of limit orders being executed at the same time when a limit price has been reached.

**Example:**

A firm has several customer limit orders to sell which total 10,000 shares at a limit price of 40. That price is reached and all such orders are executed simultaneously.

REPORT 10,000 shares at 40.

(C) Orders relayed to the trading department of the reporting member for simultaneous execution at the same price.

**Example:**

A firm purchases a block of 50,000 shares from an institution at a reported price of 40.

REPORT 50,000 at 40.

Subsequently, one of the firm's branch offices transmits to the firm's trading department for execution customer buy orders in the security totaling 12,500 shares at a reported price of 40.

REPORT 12,500 at 40.

Subsequently, another branch office transmits to the firm's trading department for execution customer buy orders totaling 15,000 shares in the security at a reported price of 40.

REPORT 15,000 at 40.

**Example:**

Due to a major change in market conditions, a firm's trading department receives from a branch office for execution customer market orders to sell totaling 10,000 shares. All are executed at a reported price of 40.

REPORT 10,000 at 40.

(D) Orders received or initiated by the reporting member that are impractical to report individually and are executed at the same price within 60 seconds of execution of the initial transaction; provided however, that no individual order of 10,000 shares or more may be aggregated in a transaction report and that the aggregated transaction report shall be made within 90 seconds of the initial execution reported therein. Furthermore, it is not permissible for a member to withhold reporting a trade in



anticipation of aggregating the transaction with other transactions. The limitation on aggregating individual orders of 10,000 shares or more for a particular security shall not apply on the first day of secondary market trading of an IPO for that security.

**Examples:**

A reporting member receives and executes the following orders at the following times and desires to aggregate reports to the maximum extent permitted under this Rule.

**First Example**

11:01:00 500 shares at 40  
 11:01:05 500 shares at 40  
 11:01:10 9,000 shares at 40  
 11:01:15 500 shares at 40  
 REPORT 10,500 shares at 40 within ninety seconds of 11:01.

**Second Example**

11:01:00 100 shares at 40  
 11:01:10 11,000 shares at 40  
 11:01:30 300 shares at 40  
 REPORT 400 shares within ninety seconds of 11:01 and 11,000 shares within ninety seconds of 11:01:10 (individual transactions of 10,000 shares or more must be reported separately).

**Third Example**

11:01:00 100 shares at 40  
 11:01:15 500 shares at 40  
 11:01:30 200 shares at 40  
 11:02:30 400 shares at 40  
 REPORT 800 shares at 40 within ninety seconds of 11:01 and 400 shares at 40 within ninety seconds of 11:02:30 (the last trade is not within sixty seconds of the first and must, therefore, be reported separately).

(2) The reporting member shall identify aggregated transaction reports and order tickets of aggregated trades in a manner directed by NASD.

**(g) Reporting Transactions on Form T**

All Reporting NASD Members required (or that elect) to report transactions to NASD's Alternative Display Facility shall report, as soon as practicable to NASD's Market Regulation Department on Form T, last sale reports of transactions in designated securities for which electronic submission to NASD's Alternative Display Facility is not possible (e.g., the ticker symbol for the security is no longer available, a market participant identifier is no longer active, or NASD will not accept the date of execution because NASD's Alternative Display Facility was closed on that date). Transactions that can be reported to NASD, whether on trade date or on

a subsequent date on an "as of" basis (T+N), shall not be reported on Form T.

**(h) Trade Tickets**

All trade tickets for transactions in Nasdaq securities shall be time-stamped at the time of execution.

**(i) Special Trade Indicator**

A Reporting Member shall append the designated symbol for special trades, step out trades, reversals, and as-of trades.

**(j) Clearing Indicators**

A Reporting Member shall use a designated symbol to denote whether the trade is to be: (i) compared in TRACS; (ii) not compared in TRACS; (iii) compared in TRACS pursuant to an Automatic Give Up Agreement ("AGU"); or (iv) not compared in TRACS, but locked in pursuant to a Qualified Service Representation Agreement ("QSR").

**(k) Transactions Not To Be Reported To NASD**

The following types of transactions effected by NASD members shall not be reported to TRACS for publication purposes:

- (1) odd-lot transactions;
- (2) transactions that are part of a primary distribution by an issuer or of a registered secondary distribution (other than "shelf distributions") or of an unregistered secondary distribution;
- (3) transactions made in reliance on Section 4(2) of the Securities Act of 1933;
- (4) transactions where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security (e.g., to enable the seller to make a gift);
- (5) purchases or sales of securities effected upon the exercise of an option pursuant to the terms thereof or the exercise of any other right to acquire securities at a pre-established consideration unrelated to the current market.

**(l) Dissemination of Transaction Reports in Convertible Debt Securities**

For surveillance purposes, NASD will collect and process trade reports for all transactions in convertible debt securities listed on Nasdaq and effected through NASD's Alternative Display Facility. On a real-time basis, NASD will disseminate to members and the public through NASD, and through securities information processors, transactions in convertible debt securities reported to it equaling 99 bonds or less.

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**5400. Nasdaq Stock Market and Alternative Display Facility Trade Reporting**

**5410. Applicability**

(a) For a period of time, NASD will operate two facilities for collecting trade reports for executions in Nasdaq National Market, Nasdaq SmallCap Market, and Nasdaq Convertible Debt securities ("designated securities"): The Nasdaq Stock Market and the Alternative Display Facility ("ADF"). Nasdaq will continue to operate the Automated Confirmation Transaction Service ("ACT"), and NASD, through the ADF, will operate Trade Reporting and Comparison Service ("TRACS"). This Rule 5400 Series establishes the rules for determining which member must report a trade and whether a trade must be reported to ACT, pursuant to the Rule 4630, 4640, 4650 and 6100 Series or TRACS, pursuant to the Rule 4630A and 6100A Series.

(b) The requirements of this Rule 5400 Series are in addition to the trade reporting requirements contained in Rule Series 4630, 4640, 4650, 6100, 4630A and 6100A Series.

**5420. Definitions**

(a) Terms used in this Rule 5400 Series shall have the meaning as defined in the NASD's By-Laws and Rules, SEC Rule 11Aa3-1, and the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation, and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on Exchanges on an Unlisted Trading Privilege Basis, unless otherwise defined herein.

(b) "Automated Confirmation Transactions Service" or "ACT" is the service that, among other things, accommodates reporting and dissemination of last sale reports in designated securities.

(c) "Registered Reporting Nasdaq Market Maker" means a member of [the Association which] NASD that is registered as a Nasdaq market maker in a particular designated security. A member is a Registered Reporting Nasdaq Market Maker in only those designated securities for which it is registered as a Nasdaq market maker. A member shall cease being a Registered Reporting Nasdaq Market Maker in a designated security when it has withdrawn or voluntarily terminated its quotations in that security or when its quotations have been suspended or terminated by action of NASD [the Association].

(d) "Non-Registered Reporting Member" means a member of [the Association which] NASD that is not a



Registered Reporting *Nasdaq* Market Maker nor a Registered Reporting ADF Market Maker.

(e) "Registered Reporting ADF Market Maker" means a member of NASD that is registered as an Alternative Display Facility ("ADF") market maker in a particular designated security. A member is a Registered Reporting ADF Market Maker in only those designated securities for which it is registered as an ADF market maker. A member shall cease being a Registered Reporting ADF Market Maker in a designated security when it has withdrawn or voluntarily terminated its quotations in that security on the ADF or when its quotations have been suspended or terminated by action of NASD.

(f) "Trade Reporting and Comparison Service" or "TRACS" is the service offered to those members that participate in the ADF that accommodates last sale reporting and dissemination and trade comparison of transactions in designated securities.

#### 5430. Transaction Reporting

(a) When and How Transactions are Reported.

(1) Registered Reporting *Nasdaq* Market Makers and Registered Reporting ADF Market Makers shall, within 90 seconds after execution, transmit [through ACT] last sale reports of transactions in designated securities executed during normal market hours. Transactions not reported within 90 seconds after execution shall be designated as late and such trade reports must include the time of execution.

(2) Non-Registered Reporting Members shall, within 90 seconds after execution, transmit through ACT or TRACS, as applicable, or if ACT or TRACS is unavailable due to system or transmission failure, by telephone to Market Operations Department, last sale reports of transactions in designated securities executed during normal market hours. Transactions not reported within 90 seconds after execution shall be designated as late and such trade reports must include the time of execution.

(3) Non-Registered Reporting Members shall report weekly to the Market Operations Department, on a form designated by the Board of Governors, last sale reports of transactions in designated securities which are not required to be reported under subparagraph (2) or (4).

#### (4) Transaction Reporting Outside Normal Market Hours

(A) Last sale reports of transactions in designated securities executed between 8:00 a.m. and 9:30 a.m. Eastern Time

shall be reported [transmitted through ACT] within 90 seconds after execution and shall be designated as ".T" trades to denote their execution outside normal market hours. Additionally, last sale reports of transactions in designated securities executed between the hours of 4:00 p.m. and 6:30 p.m. Eastern Time shall be reported [transmitted through ACT] within 90 seconds after execution; trades executed and reported after 4:00 p.m. Eastern Time shall be designated as ".T" trades to denote their execution outside normal market hours. Transactions not reported within 90 seconds must include the time of execution on the trade report.

(B) Last sale reports of transactions in designated securities executed outside the hours of 8:00 a.m. and 6:30 p.m. Eastern Time shall be reported as follows:

(i) Last sale reports of transactions executed between midnight and 8:00 a.m. Eastern Time shall be reported [transmitted through ACT] between 8:00 a.m. and 9:30 a.m. Eastern Time on trade date, be designated as ".T" trades to denote their execution outside normal market hours, and be accompanied by the time of execution. The party responsible for reporting on trade date, the information to be reported, and the applicable procedures shall be governed, respectively, by paragraphs (b), (c), and (d) below;

(ii) Last sale reports of transactions executed between 6:30 p.m. and midnight Eastern Time shall be reported [transmitted through ACT] on the next business day (T+1) between 8:00 a.m. and 6:30 p.m. Eastern Time, be designated "as/of" trades to denote their execution on a prior day, and be accompanied by the time of execution. [The party responsible for reporting on T+1, the trade details to be reported, and the applicable procedures shall be governed, respectively, by paragraphs (b), (c), and (d) below.]

(5) All members shall report as soon as practicable to the Market Regulation Department on Form T, last sale reports of transactions in designated securities for which electronic submission into ACT or TRACS is not possible (e.g., the ticker symbol for the security is no longer available or a market participant identifier is no longer active). Transactions that can be reported into ACT or TRACS, whether on trade date or on a subsequent date on an "as of" basis (T+N), shall not be reported on Form T.

(6) All members shall report transactions occurring at prices based on average-weighting, or other special pricing formulae, [to Nasdaq] using a

special indicator[, as] designated by NASD [the Association] and set out in the Symbol Directory.

(7) All trade tickets for transactions in eligible securities shall be time-stamped at the time of execution.

(8) Transactions not reported within 90 seconds after execution shall be designated as late. A pattern or practice of late reporting without exceptional circumstances may be considered conduct inconsistent with high standards of commercial honor and just and equitable principles of trade in violation of Rule 2110.

(9) All members shall append a trade report modifier as designated by NASD [the Association] to transaction reports that reflect a price different from the current market when the execution is based on a prior reference point in time, which shall be accompanied by the prior reference time.

#### (b) Which Party Reports Transaction and to Which Facility

(1) In transactions between two Registered Reporting *Nasdaq* Market Makers, [only] the member representing the sell side shall report the trade using ACT.

(2) In transactions between a Registered Reporting *Nasdaq* Market Maker and a Non-Registered Reporting Member, [only] the Registered Reporting *Nasdaq* Market Maker shall report the trade using ACT.

(3) In transactions between two Non-Registered Reporting Members, [only] the member representing the sell side shall report the trade using ACT or TRACS.

(4) In transactions between a member and a customer, the member shall report[.] as follows:

(A) A Registered Reporting *Nasdaq* Market Maker shall report the trade using ACT;

(B) A Registered Reporting ADF Market Maker shall report the trade using TRACS; and

(C) A Non-Registered Reporting Member shall report the trade using ACT or TRACS.

(5) In transactions between two Registered Reporting ADF Market Makers, the member representing the sell side shall report the trade using TRACS.

(6) In transactions between a Registered Reporting ADF Market Maker and a Non-Registered Reporting Member, the Registered Reporting ADF Market Maker shall report the trade using TRACS.

(7) In transactions between a Registered Reporting *Nasdaq* Market Maker and a Registered Reporting ADF

Market Maker, the member representing the sell side shall report as follows:

(A) A Registered Reporting Nasdaq Market Maker shall report the trade using ACT; and

(B) A Registered Reporting ADF Market Maker shall report the trade using TRACS.

(8) If a member simultaneously is a Registered Reporting Nasdaq Market Maker and a Registered Reporting ADF Market Maker, and has the trade reporting obligation pursuant to paragraphs (1), (2), (4), (5), (6), or (7), the member can report the trade using either ACT or TRACS, unless the trade is executed using ACES; the Nasdaq National Market Execution System ("NNMS"); the SelectNet Service; the SmallCap Small Order Execution System ("SOES"); or the Primex Auction System ("Primex"). A trade executed using ACES must be reported using ACT, and trades executed using NNMS, SelectNet, SOES, or Primex will be reported to ACT automatically.

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#### 6000. NASD SYSTEMS AND PROGRAMS

#### 6100. AUTOMATED CONFIRMATION TRANSACTION SERVICE (ACT)

##### 6110. Definitions

(a) through (l) No Change.

(m) The term "Reportable ACT Transaction" shall mean [all] inter-dealer transactions, including those for less than one round lot, in an ACT eligible security, and shall also include [all] transactions that are required or eligible to be submitted utilizing ACT [to the Association for trade reporting purposes] pursuant to the Rule 4630, 4640, 4650, 5400, 6400, 6600, and 6900 Series.

(n) through (p) No Change.

##### 6120. Participation in ACT

#### (a) Mandatory Participation for Clearing Agency Members

(1)(A) Participation in ACT is mandatory for all members that execute transactions using the Nasdaq National Market Execution System, the SelectNet Service, the Primex Auction System, the SmallCap Small Order Execution System; ACES; the Computer Assisted Execution System, and the Intermarket Trading System/Computer Assisted Execution System.

(B) [Pursuant to Article VII, Section 1(a)(vi) and (vii) of the By-Laws,] P[p]articipation in ACT is mandatory for [all brokers that are] members that are participants of a clearing agency registered with the Commission pursuant to Section 17A of the Act, and for [all brokers] members that have a

clearing arrangement with such a broker, unless a member subscribes to TRACS. Such participation in ACT shall include the reconciliation of all over the counter clearing agency eligible transactions.

(2) through (6) No Change.

(b) No Change.

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#### 6130. Trade Report Input

##### (a) Reportable ACT Transactions

Members shall utilize ACT to report [All] transactions [in eligible securities] that are required to be [shall be] reported to [ACT] Nasdaq pursuant to the Rule Series 4630, 4640, 4650, 5430, 6400, 6500 and 6600 Series, including executions of less than one round lot if those executions are to be compared and locked-in. Members may utilize ACT to report transactions that are eligible to be reported to Nasdaq pursuant to Rule 5430, including executions of less than one round lot if those executions are to be compared and locked-in. All trades that are reportable transactions will be processed through the National Trade Reporting System; however, only those trades that are subject to regular way settlement and are not already locked-in trades will be compared and locked-in through ACT. Trades that are reported as other than regular way settlement (i.e., Cash, Next-Day, Seller's Option) will not be compared in ACT or reported to NSCC. All transactions in Direct Participation Program securities shall be reported to ACT pursuant to the Rule 6900 Series as set forth therein.

##### (b) When and How Trade Reports are Submitted to ACT

ACT Participants shall transmit trade reports to ACT [the system] for transactions in Nasdaq securities within 90 seconds after execution, or shall utilize the Browse function in ACT to accept or decline trades within twenty (20) minutes after execution, according to the requirements of paragraph (c) of this Rule.

##### (c) Which Party Inputs Trade Reports to ACT

ACT Participants [Both parties executing a transaction] shall, subject to the input requirements below, either input trade reports into the ACT system or utilize the Browse feature to accept or decline a trade within the applicable time-frames as specified in paragraph (b) of this Rule. Trade data input obligations are as follows:

(1) through (13) No Change.

(e) No Change.

\* \* \* \* \*

#### 6000A. NASD ADF SYSTEMS AND PROGRAMS

#### 6100A. TRACS TRADE COMPARISON SERVICE

##### 6110A. Definitions

(a) The term "Browse" shall mean the function of TRACS that permits a Participant to review (or query) for trades in the system identifying the Participant as a party to the transaction, subject to the specific uses contained in the TRACS Users Guide.

(b) The term "Clearing Broker/Dealer" or "Clearing Broker" shall mean the member firm that has been identified in the TRACS system as principal for clearing and settling a trade, whether for its own account or for a correspondent firm.

(c) The term "Correspondent Executing Broker/Dealer" or "Correspondent Executing Broker" shall mean the member firm that has been identified in the TRACS system as having a correspondent relationship with a clearing firm whereby it executes trades and the clearing function is the responsibility of the clearing firm.

(d) The term "Introducing Broker/Dealer" or "introducing broker" shall mean the member firm that has been identified in the TRACS system as a party to the transaction, but does not execute or clear trades.

(e) The term "Participant" shall mean any member of NASD in good standing that uses the TRACS system as an NASD ADF Registered Reporting Market Maker according to the requirements of Rule 4611A, an ECN registered in accordance with Rule 4623A, an Order Entry Firm, or a clearing broker/dealer, correspondent executing broker/dealer, or introducing broker/dealer.

(f) The terms "Participant," "TRACS Order Entry Firm," "correspondent executing broker/dealer," "correspondent executing broker," "introducing broker/dealer," "introducing broker," "clearing broker/dealer," and "clearing broker" shall also include, where appropriate, the Non-Member Clearing Organizations listed in Rule 6120A(a)(5) below and their qualifying members.

(g) The term "Parties to the Transaction" shall mean the executing brokers, introducing brokers and clearing brokers, if any.

(h) The term "Reportable TRACS Transaction" shall mean those transactions in a TRACS eligible security that are required, or are eligible, to be submitted utilizing TRACS pursuant to the Rule 4630A, 5400 and 6400A Series. The term also shall include transactions in TRACS eligible

securities that are for less than one round lot, and those transactions that are to be compared and locked-in for settlement.

(i) The term "Reporting Party" shall mean the TRACS Participant that is required to input the trade information, according to the requirements in NASD Rule 4630A Series.

(j) The term "Trade Reporting and Comparison Service" or "TRACS" shall mean the automated system owned and operated by NASD as part of the Alternative Display Facility that reports trades and compares trade information entered by TRACS participants and submits "locked-in" trades to Depository Trust Clearing Corporation (DTCC) for clearance and settlement; transmits reports of the transactions automatically to the Securities Information Processor, if required, for dissemination to the public and the industry; and provides participants with monitoring capabilities to facilitate participation in a "locked-in" trading environment.

(k) The term "TRACS ECN" shall mean a member of NASD that is an electronic communications network ("ECN") that elects to display orders in NASD's Alternative Display Facility pursuant to Rule 4623A and is a member of a registered clearing agency for clearing or comparison purposes or has a clearing arrangement with such a member. This term shall also include an NASD member that is an alternative trading system ("ATS") that displays orders in NASD's Alternative Display Facility pursuant to Rule 4623A and is a member of a registered clearing agency for clearing or comparison purposes or has a clearing arrangement with such a member.

(l) The term "TRACS Eligible Security" shall mean Nasdaq National Market, Nasdaq SmallCap Market security and Nasdaq Convertible Debt securities.

(m) The term "TRACS Market Maker" shall mean a member of NASD that is registered as an NASD ADF Market Maker and is a member of a registered clearing agency for clearing or comparison purposes or has a clearing arrangement with such a member.

(n) The term "TRACS Order Entry Firm" shall mean a member of NASD that is a firm that executes orders but does not act as a market maker in the instant transaction and is a member of a registered clearing agency for clearing or comparison purposes or has a clearing arrangement with such a member.

6120A. Participation in TRACS Trade Comparison Feature by Participants in the Alternative Display Facility

The following Rules 6120A through 6190A apply to members that effect transactions in ADF-eligible securities through the Alternative Display Facility.

(a) Mandatory Participation for Clearing Agency Members

(1) Participation in TRACS trade comparison feature is mandatory for any NASD member that effects transactions in ADF-eligible securities through the Alternative Display Facility, which are not locked-in and sent directly to Deposit Trust Clearing Corporation ("DTCC") by that member. All members, whether or not they must participate in the TRACS trade comparison feature, must comply with the trade reporting requirements described in the Rule 4630A Series.

(2) Participation in the TRACS trade comparison feature as a Market Maker shall be conditioned upon the TRACS Market Maker's initial and continuing compliance with the following requirements:

(A) execution of, and continuing compliance with, a TRACS trade comparison Participant Application Agreement;

(B) membership in, or maintenance of, an effective clearing arrangement with a member of a clearing agency registered pursuant to the Act;

(C) registration as an NASD ADF Market Maker or ECN for Nasdaq securities pursuant to Rule 4611A, if applicable, and compliance with all applicable rules and operating procedures of NASD and the Commission;

(D) maintenance of the physical security of the equipment located on the premises of the TRACS Market Maker to prevent unauthorized entry of information into the TRACS trade comparison feature; and

(E) acceptance and settlement of each trade that the TRACS trade comparison feature identifies as having been effected by such TRACS Market Maker, or if settlement is to be made through a clearing member, guarantee of the acceptance and settlement of each TRACS identified trade by the clearing member on the regularly scheduled settlement date.

(3) Participation in the TRACS trade comparison feature as an Order Entry Firm shall be conditioned upon the Order Entry Firm's initial and continuing compliance with the following requirements:

(A) execution of, and continuing compliance with, a TRACS trade

comparison Participant Application Agreement;

(B) membership in, or maintenance of, an effective clearing arrangement with a member of a clearing agency registered pursuant to the Act;

(C) compliance with all applicable rules and operating procedures of NASD and the Commission;

(D) maintenance of the physical security of the equipment located on the premises of the TRACS Order Entry Firm to prevent the unauthorized entry of information into the TRACS trade comparison feature; and

(E) acceptance and settlement of each trade that the TRACS trade comparison feature identifies as having been effected by such TRACS Order Entry Firm, or if settlement is to be made through a clearing member, guarantee of the acceptance and settlement of each TRACS identified trade by the clearing member on the regularly scheduled settlement date.

(4) Participation in the TRACS trade comparison feature as a Clearing Broker shall be conditioned upon the Clearing Broker's initial and continuing compliance with the following requirements:

(A) execution of, and continuing compliance with, a TRACS trade comparison Participant Application Agreement;

(B) membership in a clearing agency registered pursuant to the Act;

(C) compliance with all applicable rules and operating procedures of NASD and the Commission;

(D) maintenance of the physical security of the equipment located on the premises of the TRACS Clearing Broker to prevent the unauthorized entry of information into the TRACS trade comparison feature; and

(E) acceptance and settlement of each trade that the TRACS trade comparison feature identifies as having been effected by itself or any of its correspondents on the regularly scheduled settlement date.

(5) Participation in the TRACS trade comparison feature as an ECN shall be conditioned upon the ECN's initial and continuing compliance with the following requirements:

(A) execution of, and continuing compliance with, a TRACS trade comparison Participant Application Agreement;

(B) membership in, or maintenance of, an effective clearing arrangement with a member of, a clearing agency registered pursuant to the Act;

(C) compliance with all applicable rules and operating procedures of NASD and the Commission;

(D) maintenance of the physical security of the equipment located on the premises of the ECN to prevent the unauthorized entry of information into the TRACS trade comparison feature; and

(E) acceptance and settlement of each trade that the TRACS trade comparison feature identifies as having been effected by such TRACS ECN, or if settlement is to be made through a clearing member, guarantee of the acceptance and settlement of each TRACS identified trade by the clearing member on the regularly scheduled settlement date.

(6) Each TRACS trade comparison Participant shall be obligated to inform NASD of non-compliance with any of the participation requirements set forth above.

#### (b) Participant Obligations in TRACS

##### (1) Access to TRACS

Upon execution and receipt by NASD of the TRACS trade comparison Participant Application Agreement, a TRACS trade comparison Participant may commence input and validation of trade information in TRACS eligible securities. TRACS trade comparison Participants may access the service via NASD terminals or Workstations or through computer interface during the hours of operation specified in the TRACS Users Guide. Prior to such input, all TRACS comparison Participants, including those that have trade report information submitted to NASD by any third party, must obtain from NASD a unique identifying Market Participant Symbol ("MMID" or "MPID"), and use that identifier for trade reporting and audit trail purposes.

##### (2) Market Maker Obligations

(A) TRACS Market Makers shall commence participation in the TRACS trade comparison feature by initially contacting the TRACS Operation Center to verify authorization for submitting trade data to the TRACS system for TRACS eligible securities.

(B) A TRACS Market Maker that is a self-clearing firm shall be obligated to accept and clear each trade that the TRACS trade comparison feature identifies as having been effected by that Market Maker.

(C) A TRACS Market Maker that is an introducing broker or a correspondent executing broker shall identify its clearing broker when it becomes a TRACS trade comparison participant and notify the TRACS Operation Center if its clearing broker is to be changed; this will necessitate execution of a revised TRACS trade comparison Participant Application Agreement.

(D) If at any time a TRACS Market Maker fails to maintain a clearing arrangement, it shall be removed from the TRACS trade comparison feature, and be precluded from participation as a Market Maker in ADF until such time as a clearing arrangement is reestablished and notice of such arrangement, with an amended TRACS trade comparison Participant Application Agreement, is filed with NASD. If, however, NASD finds that the TRACS Market Maker's failure to maintain a clearing arrangement is voluntary, the withdrawal of quotations will be considered voluntary and unexcused pursuant to Rule 4619A.

##### (3) Order Entry Firm Obligations

(A) TRACS Order Entry Firms shall commence participation in the TRACS trade comparison feature by initially contacting the TRACS Operation Center to verify authorization for submitting trade data to the TRACS system for TRACS eligible securities.

(B) A TRACS Order Entry Firm that is a self-clearing firm shall be obligated to accept and clear each trade that the TRACS trade comparison feature identifies as having been effected by the Order Entry Firm.

(C) A TRACS Order Entry Firm that is an introducing broker or a correspondent executing broker shall identify its clearing broker when it becomes a TRACS trade comparison Participant and notify the TRACS Operations Center if its clearing broker is to be changed; this change will necessitate execution of a revised TRACS trade comparison Participant Application Agreement.

(D) If at any time a TRACS Order Entry Firm fails to maintain a clearing arrangement, it shall be removed from the TRACS trade comparison feature until such time as a clearing arrangement is reestablished, and notice of such arrangement, with an amended TRACS trade comparison Participant Application Agreement, is filed with NASD.

##### (4) Clearing Broker Obligation

TRACS clearing brokers shall be obligated to accept and clear as a party to the transaction each trade that the system identifies as having been effected by itself or any of its correspondent executing brokers. Clearing brokers may cease to act as principal for a correspondent executing broker at any time provided that notification has been given to, received and acknowledged by the TRACS Operations Center and affirmative action has been completed by the Center to remove the clearing broker from the TRACS trade

comparison feature for that correspondent executing broker. The clearing broker's obligation to accept and clear trades for its correspondents shall not cease prior to the completion of all of the steps detailed in this subparagraph (4).

##### (5) ECN Obligations

(A) TRACS ECNs shall commence participation in the TRACS trade comparison feature by initially contacting the TRACS Operations Center to verify authorization for submitting trade data to the TRACS trade comparison feature for TRACS eligible securities.

(B) A TRACS ECN that is a self-clearing firm shall be obligated to accept and clear each trade that the TRACS trade comparison feature identifies as having been effected by the ECN.

(C) A TRACS ECN that is an introducing broker or a correspondent executing broker shall identify its clearing broker when it becomes a TRACS trade comparison Participant and notify the TRACS Operations Center if its clearing broker is to be changed; this change will necessitate execution of a revised TRACS trade comparison Participant Application Agreement.

(D) If at any time a TRACS ECN fails to maintain a clearing arrangement, it shall be removed from the TRACS trade comparison feature until such time as a clearing arrangement is reestablished, and notice of such arrangement, with an amended TRACS trade comparison Participant Application Agreement, is filed with NASD.

#### 6130A. Trade Report Input

##### (a) Reportable TRACS Transactions

Members shall utilize TRACS to report transactions that are required to be reported to NASD through the ADF pursuant to the Rule 4630A and 5430 Series, including executions of less than one round lot if those executions are to be compared and locked-in. Members may utilize TRACS to report transactions that are eligible to be reported to NASD pursuant to Rule 5430, including executions of less than one round lot if those executions are to be compared and locked-in. TRACS also will process trades that are submitted on an automatic locked-in basis for transmission to NSCC. All trades that are reportable transactions pursuant to NASD Rule 4630A Series will be transmitted to the applicable securities information processor; however, only those trades that are subject to regular way settlement and are not already

locked-in trades will be compared and locked-in through TRACS. Trades that are reported as other than regular way settlement (i.e., Cash, Next-Day, Seller's Option) will not be compared in TRACS or reported to DTCC.

*(b) When and How Trade Reports are Submitted to TRACS*

*(1) TRACS trade comparison*  
Participants who are Reporting Members that choose to submit a trade for comparison shall transmit to TRACS the information required by Rule 4630A Series, as applicable, within 90 seconds of execution.

*(2) A TRACS trade comparison*  
Participant who is a Non-Reporting Member to a transaction shall, within twenty (20) minutes after execution accept (or decline, if applicable) a transaction submitted by the Reporting Member for comparison through TRACS. A Non-Reporting Member has an obligation to ensure that the information that it transmits or accepts in TRACS is timely, accurate and complete. Therefore, if a Non-Reporting Member accepts a transaction in TRACS transmitted by the Reporting Member for comparison through TRACS, then the Non-Reporting Member shall be deemed to have adopted all of the data elements required by Rule 4632(c) or (d), as applicable, concerning the Non-Reporting Member's side of the transaction, absent any subsequent modification of the trade through TRACS.

*(3) Trades not required to be reported for public dissemination may still be compared and locked-in through TRACS.*

*(4) Reporting NASD Members may conduct the following functions in TRACS pursuant to TRACS specifications established by NASD: (i) MMID Trade Entry; (ii) Trade Cancellation; and (iii) Trade Break.*

*(5) Non-Reporting NASD Members may conduct the following functions in TRACS pursuant to TRACS specifications established by NASD: (i) Trade Accept; (ii) Trade Decline; and (iii) Trade Break.*

*(6) A party entering a trade report into the TRACS trade comparison feature shall use a designated symbol to denote whether the party is submitting the trade report as the Reporting Member or the Non-Reporting Member.*

*6140A. TRACS Processing*

Locked-in trades may be determined through the TRACS trade comparison feature through one of the following methods:

*(a) Trade Acceptance*

The reporting party enters its version of the trade into the system and the contra party reviews the trade report and accepts or declines the trade. An acceptance results in a locked-in trade; a declined trade report is purged from the TRACS system at the end of trade date processing;

*(b) T+N Trade Processing*

T+N entries may be submitted until 6:30 p.m. each business day. At the end of daily matching, all declined trade entries will be purged from the TRACS system. TRACS will not purge any open trade (i.e. unmatched or unaccepted) at the end of its entry day, but will carry-over such trades to the next business day for continued comparison and reconciliation. TRACS will automatically lock in and submit to NSCC as such any carried-over T to T+21 (calendar day) trade if it remains open as of 2:30 p.m. on the next business day. TRACS will not automatically lock in T+22 (calendar day) or older open "as-of" trades that were carried-over from the previous business day; these trades will be purged by TRACS at the end of the carry-over day if such trades remain open. Members may re-submit these T+22 or older "as-of" trades into TRACS on the next business day for continued comparison and reconciliation for up to one calendar year.

*6150A. Reserved*

*6160A. Obligation to Honor Trades*

If a TRACS trade comparison Participant is reported by TRACS as a party to a trade that has been treated as locked-in and sent to DTCC, notwithstanding any other agreement to the contrary, that party shall be obligated to act as a principal to the trade and shall honor such trade on the scheduled settlement date.

*6170A. Audit Trail Requirements*

The data elements specified in the Rule 4600A Series are critical to NASD's compilation of a transaction audit trail for regulatory purposes. As such, all member firms using the TRACS Service have an ongoing obligation to input such information accurately and completely.

*6180A. Reserved*

*6190A. Termination of TRACS Service*

NASD may, upon notice, terminate TRACS service as to a Participant in the event that a TRACS Participant fails to abide by any of the rules or operating procedures of the TRACS service or

NASD, or fails to honor contractual agreements entered into with NASD or its subsidiaries, or fails to pay promptly for services rendered by the TRACS Service.

\* \* \* \* \*

*6950. ORDER AUDIT TRAIL SYSTEM*

\* \* \* \* \*

*6954. Recording of Order Information*

(a) through (c) No Change.

(d) Order Modifications, Cancellations, and Executions

Order information required to be recorded under this Rule when an order is modified, canceled, or executed includes the following.

(1) through (2) No Change.

(3) When a Reporting Member executes an order, in whole or in part, the Reporting Member shall record:

(A) the order identifier assigned to the order by the Reporting Member,

(B) the market participant symbol assigned by [the Association] NASD to the Reporting Member,

(C) the date the order was first originated or received by the Reporting Member,

(D) the Reporting Member's number assigned for purposes of identifying transaction data in ACT,

(E) the designation of the order as fully or partially executed,

(F) the number of shares to which a partial execution applies and the number of unexecuted shares remaining,

(G) the identification number of the terminal where the order was executed, [and]

(H) the date and time of execution[.] and

(I) the national securities exchange or facility operated by a registered securities association where the trade was reported.

*7000A. CHARGES FOR ADF SERVICES AND EQUIPMENT*

*7010A. System Services*

*(a) Trade Comparison and Reporting Service*

The following charges shall be paid by ADF participants for use of the Trade Comparison and Reporting Service (TRACS):

*Transaction Related Charges:*  
Comparison—\$0.014/side per 100 shares (minimum 400 shares; maximum 7,500 shares)  
Automated Give-Up—\$0.029/side  
Late Report—T+N—\$0.30/side  
Browse/query—\$0.28/query\*

\*Each TRACS query incurs the \$0.28 fee; however, the first accept or decline processed for

Trade Reporting—\$.029/side (applicable only to reportable transaction not subject to trade comparison through TRACS)\*\*

Corrective Transaction Charge—\$.025/ Break, Decline transaction, paid by each party

*(b) Quotation Updates*

A member will be charged \$0.01 per quotation update in the ADF quotation

montage on those quotation updates that exceed three times the number of transactions reported to the ADF by the member. A "quotation update" includes any change to the price or size of a displayed quotation. This charge will be determined on a monthly basis.

*(c) Volume Discounts on Transaction and Quotation Fees*

During the initial six months of operation of the ADF, except as provided in paragraph (d) below, transaction fees incurred pursuant to paragraph (a) above, except the browse/query fee, and quotation update fees incurred pursuant to paragraph (b) above will be discounted on the following incremental basis:

Trades per month	Chargeable quotation updates per month	Discount (Percent)
Up to 2,000	Up to 8,000	0
2,001 to 4,000	8,001 to 15,000	10
4,001 to 6,000	15,001 to 25,000	25
6,001 to 8,000	25,001 to 35,000	35
8,001 or greater	35,001 or greater	50

*(d) Limited Period Without Transaction and Quotation Charges*

During the initial six months of operation of the ADF, members will not be charged for transaction fees incurred pursuant to paragraph (a) above and the quotation fees incurred pursuant to paragraph (b) above for up to a three-month period. The three-month "no transaction" fee period begins on the first day on which a member has incurred charges under paragraph (a) or paragraph (b) above, and will continue until the earlier of three months or the end of the six-month period.

*7020A. Equipment Related Charges*

The charge for using ADF terminal software shall be \$275 per month for each terminal and \$550 per month for each server.

*7030A. Reserved*

*7040A. Installation, Removal, Relocation or Maintenance*

ADF subscribers shall pay a minimum charge of \$5,000 for installation costs associated with connecting to the ADF. Upon installation, removal, relocation or maintenance of terminal and related equipment, or combination thereof, the subscriber shall pay charges incurred by NASD or its subsidiaries above the \$5,000 minimum, on behalf of the subscriber for the work being performed by the maintenance organization retained by NASD or its subsidiaries. Upon payment of \$5,000 under this provision, members will receive a credit of up to \$5,000 to be used toward their trade reporting and comparison charges imposed under Rule 7010A(a).

*7050A. Other Services*

*(a) Daily Reports to Newspapers*

Reports for regular public release, such as a list of closing quotations or market summary information for newspaper publication, shall be produced in a format acceptable to most publishers without charge. Should such information be transmitted to another location at the request of any firm, a charge may be imposed for such services by NASD or a subsidiary.

*(b) Other Requests for Data*

NASD or a subsidiary may impose and collect compensatory charges for data supplied upon request, where there is no provision elsewhere in this Rule 7000A Series for charges for such service or sale.

*(c) Testing Services*

(1) Subscribers that conduct tests of their computer-to-computer (CTCI) or digital interface (DIS/CHIPS) with the central processing facilities of Alternative Display Facility shall pay the following charges:

- \$285/hour—For CTCI/DIS/CHIPS testing between 9:00 a.m. and 5:00 p.m. Eastern Time on business days;
- \$333/hour—For testing at all other times on business days, or on weekends and holidays.

(2) The foregoing fees shall not apply to testing occasioned by:

- (A) new or enhanced services and/or software provided by ADF or
- (B) modifications to software and/or services initiated by ADF in response to a contingency.

*7060A. Partial Month Charges*

The charges for the month of commencement or termination of service will be prorated based on the number of trade days in that month.

*7070A. Reserved*

*7080A. Late Fees*

(a) All charges imposed by NASD that are past due 45 days or more will be subject to a late fee computed by taking the summation of one and one-half percent (1½%) of the amount past due for the first month plus one and one-half percent (1½%) of the amount past due for any month thereafter, compounded by late fees assessed for previous months.

(b) To illustrate how late fees are assessed, if an account is past due \$1,000 for 45 days, the late fee would be \$30.22. This charge reflects a charge of \$15 for the first month past due (\$1,000 × 1½%) and \$15.22 for the second month past due (\$1,015 × 1½%).

*7100A. Minor Modifications in Charges*

(a) To compensate for minor variations in annual net income, the Board of Governors of NASD may increase or decrease the total charges in this Schedule by 10% from the base charges as adopted on [insert adoption date] upon filing such change with the Commission pursuant to Section 19(b)(3) of the Act.

(b) To facilitate the development of new information services and uses under appropriate terms and conditions, arrangements of limited duration, geography and/or scope may be entered into with Broker/Dealers,

a transaction is free, to insure that no more than \$0.28 is charged per comparison. Subsequent queries for more data on the same security will also

be processed free. Any subsequent query on a different security will incur the \$0.28 query charge.

\*\*The trade reporting service charge is applicable to those trades input into TRACS for reporting

purposes only, such as NSCC Qualified Special Representative reports and reports of internalized transactions.



*Vendors and other persons which may modify or dispense with some or all of the charges contained in this Rule or the terms and conditions contained in standard agreements. The arrangements contemplated will permit the testing and pilot operation of proposed new information services and uses to evaluate their impact on and to develop the technical, cost and market research information necessary to formulate permanent charges, terms and conditions for filing with and approval by the Commission.*

\* \* \* \* \*

9000. Code of Procedure

9100. Application and Purpose

\* \* \* \* \*

9120. Definitions

(a) through (r) No Change.

(s) "Market Regulation Committee"

The term "Market Regulation Committee" means the committee of NASD [Regulation] designated to consider the federal securities laws and the rules and regulations adopted thereunder and various *NASD Rules* [of the Association] and policies relating to:

(1) through (3) No Change.

(4) trading practices, including rules prohibiting manipulation and insider trading, and those Rules designated as Trading Rules (Rule 3300 Series), the Nasdaq Stock Market Rules, (Rule 4000 Series), *NASD Alternative Display Facility Rules (Rule 4000A Series)* other Nasdaq and NASD Market Rules (Rule 5000 Series), NASD Systems and Programs Rules (Rule 6000 and 6000A Series), and Charges for Services and Equipment Rules (Rule 7000 and 7000A Series).

(t) through (cc) No Change.

\* \* \* \* \*

9700. Procedures on Grievances Concerning the Automated Systems

9710. Purpose

The purpose of this Rule 9700 Series is to provide, where justified, redress for persons aggrieved by the operations of any automated quotation, execution, or communication system owned or operated by *NASD* [the Association], or any subsidiary thereof, and approved by the Commission, not otherwise provided for by the Code of Procedure as set forth in the Rule 9000 Series the Uniform Practice Code as set forth in the Rule 11000 Series or the Procedures for Review of Nasdaq Listing Determinations as set forth in the Rule 4800 Series.

\* \* \* \* \*

9720. Form of Application

All applications shall be in writing, and shall specify in reasonable detail the nature of and basis for the redress requested. If the application consists of several allegations, each allegation shall be stated separately. All applications must be signed and shall be directed to Nasdaq relating to automated quotation, execution or communications system owned or operated by Nasdaq and to NASD for any such system owned and operated by *NASD*.

\* \* \* \* \*

9730. Request for Hearing

Upon request, the applicant shall be granted a hearing after reasonable notice. In the absence of such request for a hearing, *NASD or Nasdaq, as applicable*, may, in its discretion, have any application set down for hearing or consider the matter on the basis of the application and supporting documents.

**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 NASD included statements concerning the purpose of, and the 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. NASD 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

*Background.* NASD is proposing to operate the ADF on a pilot basis for nine months, pending the anticipated approval of the ADF Proposal and the anticipated approval of Nasdaq as a national securities exchange<sup>4</sup> and its resultant separation from NASD. As described in detail in the ADF Proposal, the ADF is a quotation collection, trade comparison, and trade reporting facility developed by NASD in accordance with the Commission's approval order for Nasdaq's Order Collector and Display Facility ("SuperMontage")<sup>5</sup> and in conjunction with Nasdaq's anticipated

registration as a national securities exchange.

The ADF Pilot will provide ADF Pilot market participants<sup>6</sup> the ability to post quotations in Nasdaq securities and will provide all NASD members that participate in the ADF Pilot the ability to view quotations and report transactions in Nasdaq securities to the appropriate Securities Information Processor ("SIP")<sup>7</sup> for consolidation and dissemination of data to vendors and ADF Pilot Market Participants. The facility also will provide for trade comparison through the Trade Comparison and Reporting Service ("TRACS"), which is described in detail below. The facility further will provide for real-time data delivery to NASD for regulatory purposes, including enforcement of firm quote and related rules.

As proposed in the ADF Proposal, the ADF would provide Market Participants the ability to quote and trade Nasdaq and exchange-listed securities. However, several regulatory issues relating to the trading of exchange-listed securities on the ADF have not been resolved. Because these open issues do not relate to trading Nasdaq securities, NASD is proposing to operate the ADF Pilot with respect to Nasdaq National Market and Nasdaq SmallCap Market securities (collectively, "Nasdaq Securities") only. The ADF Pilot would operate on a pilot basis until the close of daily operation of the ADF Pilot on April 24, 2003.

During the ADF Pilot, the NASD will own and operate both Nasdaq and the ADF Pilot. Accordingly, the proposed rules for the ADF Pilot relating to specific quotation and trading requirements for activities through the ADF Pilot are separate from the quotation and trading rules relating to Nasdaq. Further, certain Nasdaq rules have been amended to reflect the fact that members that choose to participate in both Nasdaq and the ADF Pilot may elect to trade report to either facility, except for those transactions that are executed or facilitated by a Nasdaq system.<sup>8</sup>

The proposed ADF Pilot trade reporting rules are consistent with current requirements applicable to

<sup>6</sup>Proposed ADF Pilot Rule 4300A defines "Market Participants" as either an NASD registered Market Maker or an NASD Registered electronic communication network ("ECN").

<sup>7</sup>Nasdaq initially will be the designated SIP for all transactions in Nasdaq securities. It is anticipated that during the ADF Pilot, the SIP will distribute a best bid and offer for both NASD and Nasdaq. See note 24, *infra* for further discussion on this issue.

<sup>8</sup>See proposed ADF Pilot Rule 4630, Rule 5430, and Rule 6100.

<sup>4</sup>Securities Exchange Act Release No. 44396 (June 7, 2001), 66 FR 31952 (June 13, 2001) (File No. 10-131).

<sup>5</sup>Securities Exchange Act Release No. 43863 (January 19, 2001), 66 FR 8020 (January 26, 2001) (File No. SR-NASD-99-53).



Nasdaq market participants and are not intended to require new or different trade reporting responsibilities for parties to transactions. As described in more detail herein, the proposed Rule 5400 Series details which party to a transaction has the trade reporting responsibility and where the party with the trade reporting responsibility is required, or has the choice, to trade report to TRACS or ACT.

**Market Maker and ECN Registration.** As required by existing rules applicable to Nasdaq market makers, ADF Pilot Market Participants would be required to register as market makers or electronic communications networks ("ECNs") for each security in which they make a market or display orders. Market makers would receive approval for registration upon demonstration that they are members in good standing and comply with the net capital and other financial responsibility requirements of the Act. To ease the administrative burden on NASD members, the ADF Pilot rules initially would allow registration as a market maker in the ADF Pilot upon proof that a firm is a registered Nasdaq market maker. Additionally, the proposed rule change tracks Nasdaq requirements that market makers maintain continuous two-sided, firm quotations and prescribes market maker obligations when a bid or offer locks or crosses the market. ECNs, however, may post one-sided quotes. If a Registered ADF Pilot market maker that also is a Registered Nasdaq market maker is seeking excused withdrawal status, it must obtain such excused withdrawal status in both facilities for the same time period.

**Order Access Rule.** The ADF Pilot rules differ from current rules applicable to trading in Nasdaq securities most significantly with respect to participants' ability to reach quotes for Nasdaq securities displayed in the ADF Pilot. NASD will not provide Market Participants in the ADF Pilot an order routing capability.<sup>9</sup> To provide a means to enforce compliance with firm quote obligations, locked and crossed

quotation obligations,<sup>10</sup> and to provide other market participants within the ADF Pilot and in other markets the ability to provide best execution, in the absence of an NASD-provided router, the proposed rule change contains new Rule 4300A.

**Direct and Indirect Access.** Generally, proposed Rule 4300A requires NASD Market Participants to provide direct electronic access to other Market Participants and to provide to all other NASD members direct electronic access and allow for indirect electronic access to the individual Market Participant's quote. As discussed above, the rule defines Market Participants as either an NASD Registered Market Maker or an NASD Registered ECN. In other words, Market Participants are those members that post quotations in the ADF Pilot.

The rule requires Market Participants to provide other Market Participants with direct electronic access to their quotes. "Direct electronic access" is defined in the rule as the ability to deliver an order for execution directly against an individual NASD Market Participant's best bid or offer without the need for voice communication, with equivalent speed, reliability, availability, and cost, as are made available to NASD Market Participant's own customers. Therefore, while the linkage must be electronic—telephone access is insufficient—the proposed rule allows Market Participants flexibility to determine the type and method of linkage. For example, the proposed rule would permit Market Participants to link directly among themselves bilaterally using their own technology or to use a provider with multilateral order routing facilities to satisfy the linkage requirements. The rule requires that a Market Participant be equally accessible to all other Market Participants via this electronic link.

The quote access requirements of proposed Rule 4300A would not extend to intermarket access for trading Nasdaq securities. Unlike for CQS securities, the Commission has not mandated an intermarket linkage like ITS for Nasdaq securities. Accordingly, the NASD does not believe it appropriate for it to unilaterally impose such an intermarket linkage obligation. Rather, the NASD would propose that members of another market that desire to access a Market Participant's quotes in the ADF Pilot in Nasdaq securities establish an execution arrangement with that ADF Pilot Market Participant or, alternatively, become a member of the NASD.

The proposal also would require Market Participants to provide all other NASD broker-dealer members (*i.e.*, those members that do not quote in ADF Pilot but want to access ADF Pilot quotes) with direct electronic access and allow for indirect electronic access through their customer broker-dealers. Indirect electronic access is defined in the proposal as the ability to route an order through a Market Participant's customer broker-dealer for execution against the Market Participant's best bid and offer, without the need for voice communication, with equivalent speed, reliability, availability, and cost, as are made available to the Market Participant's customer broker-dealer providing access to the Market Participant's quotes.

The proposed rule change requires a Market Participant to offer both direct and indirect access to member broker-dealers. Market Participants must make themselves accessible to those member broker-dealers that wish to link with them directly and also must permit access indirectly through their customer broker-dealers. Similarly, the requirement to allow for indirect access does not permit Market Participants to refuse direct access to member broker-dealers that would prefer direct connectivity; rather, it creates an additional means for non-Market Participant broker-dealers to access Market Participants' quotes.

Rule 4300A prohibits Market Participants from in any way discouraging or discriminating against NASD members that wish to reach their quotes. NASD believes this approach is the most appropriate means to ensure equal and universal access by its members to the quotations displayed in the ADF Pilot. A Market Participant may deny access only in the limited circumstances where a broker-dealer fails to pay contractually obligated costs for access to a Market Participant's quotes; otherwise, Market Participants must provide access to their quotes displayed in the ADF Pilot to all NASD member broker-dealers seeking such access.

The order access rule would apply only to a Market Participant's top of book, *i.e.*, the best bid and offer that is displayed in the ADF Pilot. Therefore, Market Participants retain substantial flexibility to negotiate the terms of many other services, such as full book access, placing orders, and use of reserve sizes. ECNs are permitted under the proposed rule to charge more for "hit or take" access only "purely a liquidity taking function—than for full subscriber services, provided that the fee is

<sup>9</sup> The NASD will not provide an order routing capability for Nasdaq securities because the NASD believes this will allow it to better perform its core investor protection mission by focusing on regulation rather than market operations. The NASD also believes that market participants already do, and can continue to, establish and run order linkage facilities that are as or more efficient and innovative than a facility NASD could provide. The NASD believes that this approach comports with the requirements of the Act and is consistent with the NASD's obligation to promulgate rules that are designed generally to facilitate the orderly collection, distribution, and publication of quotations in securities traded otherwise than on a national securities exchange. See Section 15A(b)(11) of the Act, 15 U.S.C. 78o-3(b)(11).

<sup>10</sup> This proposed Rule 4300A would be the basis for satisfying, among other things, locked and crossed quotation obligations.

reasonable, based on objective criteria, and not imposed discriminatorily.

**Cost Allocation.** Under the proposed rule change, Market Participants must share equally the costs of providing to each other the direct electronic access required by rule, unless those Market Participants agree upon another cost-sharing arrangement. For example, assume the ADF Pilot consisted of five Market Participants and a sixth broker-dealer then registered as an ADF Pilot Market Participant. Under this scenario, each of the five existing Market Participants would be required to split with the new Market Participant the costs to establish their respective bilateral links with the new Market Participant, unless the parties agreed upon a different cost allocation.

Market Participants also must pay the costs to enable direct electronic access, as defined in the proposed rule, to their quotes. Thus, a Market Participant must bear the costs to build, upgrade or otherwise reconfigure its technology to allow other broker-dealers to connect to it, including the costs to accommodate additional volume resulting from indirect electronic access order flow through customer broker-dealers. NASD believes that these costs are part and parcel of choosing to operate in the ADF Pilot as a Market Participant and therefore must be borne by the Market Participant. Similarly, those non-Market Participant broker-dealers seeking access to a Market Participant's quote must bear the line or other costs necessary to connect with a Market Participant's network to send and receive orders.

**Access Fees.** A customer broker-dealer may charge its customers a fee to provide indirect access to a Market Participant's quotes. Under the rule proposal, a Market Participant may not influence or prescribe what a customer broker-dealer may charge its customers for indirect access to the Market Participant.<sup>11</sup> Nor may the Market Participant preclude or discourage a specific customer broker-dealer from providing indirect access, either through discriminatory pricing or by degrading its quality of service to its customer broker-dealer. A Market Participant may, however, offer to provide direct electronic access at a competitive price as part of the services it provides to customers.

Connectivity costs should be distinguished from fees for various other services provided by Market

Participants. NASD recognizes that Market Participants have a variety of existing business relationships with broker-dealers for which they charge fees for services rendered, e.g., the handling of limit orders, price improvement opportunities, and liquidity enhancement. Market Participants may continue to assess fees for these types of services, as permissible under current rules and regulations.

While ECNs may charge to execute against their best bid and offer, the fee must be based on reasonable and objective criteria. And while ECNs are permitted under the proposal to charge more for hit-or-take access than for full service access, they may not impose hit-or-take fees in a way that discriminates against a particular broker-dealer or class of broker-dealers. Thus, in setting its fee schedule, an ECN may not look through its order flow to identify and discriminate against the source of the order flow, e.g., a competitor or a broker-dealer that is accessing the quote indirectly. Rather, an ECN may set a reasonable fee for order flow that takes liquidity—a fee that may be higher than for order flow that provides liquidity—and apply that fee to all such order flow, irrespective of its origin. Similarly, an ECN that offers a volume discount must offer the same terms to all broker-dealers accessing its quote, without regard to the identity of the broker-dealer or the source of its order flow. NASD believes that this rule is necessary to ensure fair and equitable access to ECN quotes displayed in the ADF Pilot.

**Performance Standards.** Because the ADF Pilot will not be providing an order router or automatic execution system, NASD believes that a minimum performance standard is appropriate to ensure that quotes in the ADF Pilot are reliable and accessible. Specifically, the proposed rule change would impose a technological requirement on Market Participants, mandating that their order linkage system provide them the capability to respond to an order—i.e., accept or decline it—from another Market Participant or customer broker-dealer, within two seconds of receipt. Additionally, Market Participants would be required to have in place a system that can accomplish a “round trip” of an order from another Market Participant in three or fewer seconds, measured from the time an order is released by a Market Participant until the time notification of action taken on the order is received back by the Market Participant from whom the order originated. In short, there are two relevant time standards to ensure a

minimum performance capability: Three-second turnaround for communications between Market Participants and two seconds for execution of orders received by Market Participants from other Market Participants, as well as customer broker-dealers.

Market participants will be required to certify that their systems can meet these standards at peak capacity, based on reasonable forecasts, before they are authorized to post quotes on the ADF Pilot. On an ongoing basis, Market Participants will be required to re-certify that they can meet these performance standards when volumes exceed those on which the initial certification was based. NASD will review test data to confirm the accuracy of such certifications.

The proposed performance standards are independent of existing firm quote requirements in Rule 11Ac1-1 under the Act,<sup>12</sup> NASD Rule 3320 and proposed NASD Rule 4613A(b), which require immediate execution of an order up to the quotation size displayed by the Market Participant upon receipt of an order to buy or sell. The performance standards ensure that all Market Participants have adequate technology that will not degrade the overall accessibility of quotes in the ADF Pilot. By comparison, the firm quote rule addresses a Market Participant's obligation to honor their quotes when they receive an order and prohibits backing away. Accordingly, the proposal would not require market makers to fill orders in two seconds. However, due to their structure, broker-dealers whose business models rely primarily upon electronic execution systems, for example ECNs, would be expected to fill orders in less than two seconds.

**System Outages.** In addition, to further ensure the reliability of linkages and the integrity of the ADF Pilot, the NASD is proposing to suspend from quoting for 20 business days any Market Participant that experiences three unexcused, confirmed system outages during any period of five business days.

NASD proposes to define system outages as (1) an inability to quote or (2) an inability to respond to orders. The proposal provides for a review and appeal process, where the burden will rest with the Market Participant to establish that a confirmed system outage was attributable to another party. The proposal also would give NASD discretion to excuse certain outages where the Market Participant voluntarily brings the matter to the

<sup>11</sup> The fact that a Market Participant has an ownership interest in a customer broker-dealer or multilateral linkage provider does not, in and of itself, constitute influence for the purposes of this proposed rule.

<sup>12</sup> 17 CFR 240.11Ac1-1.

attention of NASD. Finally, NASD will investigate complaints related to failure to provide direct or indirect access.

**Trading Rules Compliance.** To allow NASD to monitor compliance with certain trading rules, such as the firm quote rule and "trade or move" rules, the proposed rule change also requires that all NASD Market Participants that display quotations or orders in the ADF Pilot record specified items of information pertaining to orders they receive from broker-dealers via direct or indirect electronic access, and report this information to NASD on a real-time basis. The proposed rule requires this information be provided to NASD within 10 seconds of the receipt of an order and, if applicable, when an order is acted upon or responded to. As part of the subscriber agreement approval process, Market Participants would be required to provide the terms and methods by which they will comply with these rules. The NASD would review these terms prior to approving a subscriber agreement.

**Trade Reporting and Trade Comparison Service.** As noted above, the NASD intends to operate trade reporting and comparison services as part of the ADF Pilot. The trade reporting service would collect trade reports for NASD Market Participants, as well as any NASD member that chooses to or is required to report transactions through the ADF Pilot. The service would transmit the reports automatically to the respective SIP, if required, for dissemination to the public and the industry.

This service would operate similarly to the trade reporting functions of Nasdaq's Automated Confirmation Transaction ("ACT") Service,<sup>13</sup> but would contain one notable distinguishing feature. The ADF Pilot will support a "three party trade report" that will make it easier for ECNs to submit trade reports involving their subscribers and for market makers to submit riskless principal trade reports. A three party trade report will be a single last sale trade report that would denote one reporting member—i.e., the party with the trade reporting responsibility as defined in Rule 4633A—and two contra parties. The ADF will be designed to split the three party trade report into two separate reports that will then be processed independently in accordance with existing trade reporting rules. Each of these reports will contain its own identifier and a reference to the original

three party trade report, so that the separate reports can be mapped to the same transaction. Therefore, the ADF Pilot trade reporting system would streamline the reporting process by reducing from three or two to one the number of trade reports for most ECN and riskless principal transactions.

The NASD also will operate a trade comparison service as part of TRACS that would (1) compare trade information entered by TRACS participants and submit "locked-in" trades to the Depository Trust Clearing Corporation ("DTCC") for clearance and settlement; (2) transmit reports of the transactions automatically to the respective SIP, if required, for dissemination to the public and the industry; and (3) provide participants with monitoring capabilities to facilitate participation in a "locked-in" trading environment. The proposed trade comparison rules are found in proposed Rule 6100A.

The NASD expects that a significant volume of trades will be locked-in and submitted directly to DTCC by way of agreements between Market Participants and Qualified Service Representatives ("QSRs"). As a result, NASD expects the volume of trades requiring comparison sent through TRACS to be relatively low.<sup>14</sup> For those trades where one party is a TRACS subscriber and the other party is an ACT subscriber, both TRACS and ACT will accept one-sided trade reports and submit those trades to NSCC. In such cases, NSCC will compare the trade.

**Transaction Reporting.** The proposed rule change adopts the current Nasdaq approach to trade reporting for Nasdaq securities whether the member is reporting through TRACS or ACT. Proposed Rule 5430(b) designates which party to a transaction has the trade reporting responsibility and where the party with the trade reporting responsibility is required, or has the choice, to trade report to TRACS or ACT. Specifically, proposed Rule 5430(b) requires that the seller report trades between two market makers or two non-market makers, the market maker report trades between it and a customer, and an NASD member report trades between it and a customer.

The proposed rule change also provides NASD members that are market makers in both the ADF Pilot and Nasdaq and have a trade reporting obligation under Rule 5430(b), the choice to trade report to the ADF Pilot

or Nasdaq, except for those transactions that are executed or facilitated by a Nasdaq system. If a member is a market maker in either Nasdaq or the ADF Pilot, but not the other facility, the member must report to the facility of which it is a market maker. For example, if a member is an ADF Pilot market maker, but not a Nasdaq market maker in a security, the member, if it has a trade reporting obligation, must report the transaction in that security to TRACS, unless the trade is executed using ACES, the Nasdaq National Market Execution System ("NNMS"), the SelectNet Service, the SmallCap Small Order Execution System ("SOES"), or the Primex Auction System ("Primex"). A trade executed using ACES must be reported using ACT, and trades executed using NNMS, SelectNet, SOES, or Primex will be reported to ACT automatically. A member that is not a market maker in either facility but is a participant in both facilities and has a trade reporting obligation, may trade report to either facility, unless the trade is executed using ACES, NNMS, SelectNet, SOES, or Primex. Trades executed using ACES must be reported to ACT, and trades executed using these other systems will be reported to ACT automatically.

With respect to trade reporting by ECNs, ECNs that currently display quotes in Nasdaq have developed different methods of reporting trades. ECNs may continue to report to Nasdaq and/or the ADF in this same manner.

**Short Sale Rule.** The proposed rule change would amend the short sale rule and its accompanying interpretation such that the current Nasdaq short sale rule should apply to trading in Nasdaq Securities on the ADF Pilot with the exception described below. The proposed rule change, however, would establish a different bid on which to base the applicability of the short sale rule for purposes of trading on the ADF Pilot. Specifically, the proposed amendment would require members trading on the ADF Pilot to comply with the short sale rule based on the national best bid rather than the Nasdaq best bid. Although a best bid will be calculated for the ADF Pilot, NASD believes that for the purposes of the short sale rule, the national best bid will be more reflective of market-wide trading in a security and therefore will better further the purposes of the rule. Aside from the changes noted above, the ADF Pilot short sale rule would mirror Nasdaq's short sale rule, including the current exemption for registered market makers engaged in bona fide market making activity.

<sup>13</sup> The NASD service would not perform risk management services that are provided by Nasdaq's ACT service.

<sup>14</sup> DTCC has agreed to continue its existing trade comparison service for over-the-counter equity securities to provide comparison services between an ADF Pilot Market Participant and a Nasdaq market participant.

*Trading Halts.* Proposed Rule 4120A would provide the NASD with authority to halt trading through the ADF Pilot in Nasdaq Securities. For ADF Pilot-eligible securities, the proposed rule would mandate a trade halt when another market halts trading in a security for regulatory reasons and would give the NASD discretionary authority to halt trading when another market halts trading for operational reasons. Similar discretionary authority would extend to circumstances where a security traded through the ADF Pilot is a derivative or component of a security that has been halted. In addition, the NASD would have authority to close the ADF Pilot to quotation activity when the ADF Pilot is unable to transmit real-time quotation and trade reporting data to the SIP. In the event that the NASD chooses not to halt trading under the aforementioned discretionary circumstances, market participants could continue to trade through the ADF Pilot and would be required to meet all applicable trade reporting requirements.

Any trading halt initiated by the NASD would become effective simultaneously with notification via an administrative message sent through the ADF Pilot terminal or interface. Trading similarly would resume after an administrative notice has been issued.

*Withdrawal of Quotations.* The proposed rule change eliminates for ADF market makers one of the conditions in existing Rule 4619(b)(3) for a market maker seeking excused withdrawal status based on vacation. Under the current rule, excused withdrawal status may only be granted to a market maker that has three or fewer Nasdaq Level 3 terminals. Proposed Rule 4619A(b)(3) does not replicate that requirement for ADF Pilot market makers because the ADF Pilot will not operate as a primary market. As such, the absence of a market maker with more than three ADF Pilot terminals would not have a significant impact on the liquidity in those securities in which it makes a market.

*Obligations When Quoting in Multiple Market Centers.* Existing Rule 2320(g)(2) requires members that display quotations for non-Nasdaq securities in two or more quotation mediums to post the same priced quotations in each medium. The proposed rule change adds a similar obligation under proposed Rule 4613A(e)(1) for members that display quotations for Nasdaq Securities in two or more market centers, including the ADF Pilot. The proposed rule, however, does not prohibit displaying different size quotations in two or more mediums or

market centers, provided that the price displayed is the same.

*Obligation to Have Quotations From Other Market Centers in Close Proximity.* Proposed Rule 4613A(e)(2) would require a registered NASD market maker to have in close proximity to the ADF Pilot terminal or interface at which it makes a market in a Nasdaq security a quotation service that disseminates quotations in that security. A similar rule, Rule 6330(c), currently exists with respect to CQS market makers. As with the CQS rule, it is the NASD's intention for the quotations displayed in the ADF Pilot terminals or interfaces to function as a verification mechanism whereby Market Participants in the ADF can monitor their current ADF Pilot quotations and ensure that the NASD is timely updating and disseminating their quotations. NASD will not disseminate to Market Participants in the ADF Pilot any consolidated quotation or trade data in a security from securities exchanges and market centers. To ensure that ADF Pilot Market Participants have the data necessary to make proper order routing decisions and to satisfy the Vendor Display Rule,<sup>15</sup> NASD will require Market Participants in the ADF Pilot to obtain from vendors dynamic quotations and last-sale information on the securities they trade through the ADF Pilot, and to display this data in close proximity to the ADF Pilot data displayed on their terminals, just as is currently required of CQS market makers in Rule 6330(c).

*Voluntary Termination of Registration.* The proposal contains a new provision related to voluntary termination as an NASD market maker. Proposed Rule 4620A provides that registration as a Registered ADF market maker in a security is voluntarily terminated where the market maker (1) withdraws its quotations from the ADF Pilot and does not re-enter quotations in the security for five minutes or (2) fails to re-enter quotations within 30 minutes of the end of a trading halt. In either circumstance, a market maker would be prohibited from re-registering as an ADF Pilot market maker in that security for twenty (20) business days, unless the market maker meets the conditions for excused withdrawal specified in Rule 4619A.

*OATS Requirements.* For NASD members, the Order Audit Trail System ("OATS") requirements will remain substantially the same as current requirements. NASD, however, is proposing to require that members complete an additional field on the

OATS execution report indicating where the trade was reported. This requirement will enable the NASD to clearly identify which execution reports are associated with ADF Pilot trade reports and which are associated with Nasdaq trade reports and, thereby, keep this data separate and confidential, as necessary.

All NASD members must continue to record in electronic form and report to the NASD on a daily basis certain information with respect to orders originated, received, transmitted, modified, canceled, or executed ("reportable events") by NASD members relating to equity securities traded on Nasdaq. When the ADF Pilot and Nasdaq are both operating, NASD members, in many cases, will have at least two options as to where they may choose to report their transactions in Nasdaq Securities. As such, NASD will be required to "match" OATS execution reports to either TRACS data or ACT data (or neither) depending upon where the transaction was reported. By having a field in the OATS execution report indicating where the trade was reported, NASD systems will be able to more efficiently compare the execution report to the appropriate trade report.

*Fees and Assessments.* The proposed rule change includes proposed fees and assessments in the proposed Rule 7000A Series applicable to the ADF Pilot. These proposed fees are substantially similar to those fees proposed in the ADF Proposal, except in two ways that are described below. The following are fees that will be charged relating to transactions on the ADF Pilot: Comparison—\$0.014/side per 100 shares (minimum 400 shares; maximum 7,500 shares); Automated Give-Up—\$0.029/side; Late Report—T+N—\$0.30/side; Browse/query—\$0.28/query; Trade Reporting—\$.029/side (applicable only to reportable transaction not subject to trade comparison through TRACS); and Corrective Transaction Charge—\$0.25.

The NASD will charge an ADF Pilot workstation fee of \$275 per month for each ADF Pilot terminal software license and \$550 per month for each ADF Pilot server license. The NASD also will charge members a minimum of \$5,000 for installation costs associated with connecting to the ADF Pilot, and will require reimbursement from members for charges incurred by the NASD above \$5,000 due to the installation, removal, relocation or maintenance of terminal and related equipment. However, the NASD will provide market participants with a credit of up to \$5,000 toward their trade reporting and comparison charges.

<sup>15</sup> Securities Exchange Act Rule 11Ac1-1, 17 CFR 240.11Ac1-1.

The proposed rule change also provides for several administrative provisions, including partial month charges and late charges for all fees that are past due 45 days or more. The proposed rule change also permits the NASD to increase or decrease the total charges described in the Rule 7000A series by 10% upon filing such changes with the SEC. Similar to existing NASD Rule 7100(b), the proposed rule change also permits the NASD to enter into agreements with certain broker/dealers, vendors and other persons, which may modify or dispense with some or all of the charges described in the 7000A Series.

NASD also is proposing to charge a quotation update fee of \$.01 per quotation update in the ADF Pilot quotation montage. This quotation update fee, however, will apply only to those quotation updates by the member in the ADF Pilot that exceed three times the number of transactions reported by the member through the ADF Pilot. This quotation update fee will be determined on a monthly basis. By imposing this fee only where the quotation updates

significantly exceed the number of transactions reported, this fee structure will fairly impose costs on those members whose quotation activity creates system capacity demands, and therefore costs that are not covered by a trade reporting fee.

As noted above, the proposed ADF Pilot fees differ with respect to the ADF fees proposed in the ADF Proposal in two ways. First, NASD is proposing to waive transaction and quotation update fees (proposed Rules 7010A(a) and (b), respectively) for a period of up to three months during the initial six months of operation of the ADF Pilot. As a result, during this six-month period, for up to three months starting from the initial transaction by an ADF Pilot participant, the participant would not be charged transaction or quotation fees. However, the time period for which the three months of "no charges" is available concludes at the end of the six-month period, irrespective of whether the member has participated in the ADF Pilot for three months. For example, if the ADF Pilot has been operational for four months and a market participant

begins trading at that time, it only would be eligible for "no charges" for two months.

Second, for the initial six month period of the ADF Pilot's operation, NASD is proposing to adjust its fees imposed on trade reporting and quotation activities through the ADF Pilot to provide for volume discounts subsequent to the three month "no charges" period. NASD believes that this approach will make the overall cost of trade reporting and quoting through the ADF Pilot more attractive to higher volume users during the first six months of ADF Pilot's operation. Specifically, the proposed fee structure would provide discounted fees for those members that have greater than 2,000 trades per month or for those members that have greater than 8,000 chargeable quotes per month. The proposed volume discounts would apply to all transaction fees incurred under proposed Rule 7010A(a), except the browse/query fee, and all quotation update fees incurred under proposed Rule 7010A(b). The discounts would apply in the following increments:

Trades per month	Chargeable quote updates per month	Discount (percent)
Up to 2,000 .....	Up to 8,000 .....	0
2,001 to 4,000 .....	8,001 to 15,000 .....	10
4,001 to 6,000 .....	15,001 to 25,000 .....	25
6,001 to 8,000 .....	25,001 to 35,000 .....	35
8,001 or greater .....	35,001 or greater .....	50

For example, if a member had 5,000 trades and 16,000 quotation updates during a month, the proposed fee structure would apply as follows: no discount would apply to the first 2,000 trades; the fees imposed on trades 2,001 through 4,000 would be discounted by 10%; and the fees imposed on trades 4,001 through 5,000 would be discounted by 25%. The quotation update charge on 1,000 quotations (those quotations that exceed three times the number of trades) would not be discounted because it is less than 8,001.

## 2. Statutory Basis

The NASD believes that the proposed rule change is consistent with section 15A(b)(6) of the Act<sup>16</sup> in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination among persons engaged in regulating, clearing, settling, processing information and facilitating transactions

in securities, 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. In addition, the NASD believes that this rule proposal is consistent with section 15A(b)(6) of the Act<sup>17</sup> because it does not permit unfair discrimination between customers, issuers, brokers, or dealers, to fix minimum profits, to impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by members, or to regulate matters not related to the purposes of the Act or the administration of the Association.

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

The NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

## C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

Written comments were solicited in response to the ADF Proposal. As noted above, the proposed rule changes of the ADF Pilot are substantially similar to those rule changes proposed in the ADF Proposal that are related to the establishment, implementation, and operation of the ADF. The NASD has responded to the comments received in response to the ADF Proposal. Specifically, the NASD responded to the comments received in response to SR-NASD-2001-90 in its Amendment No. 2 to that filing submitted to the SEC on May 24, 2002.<sup>18</sup> The NASD responded to the comments received in response to SR-NASD-2002-28 in its Amendment

<sup>16</sup> 15 U.S.C. 78o-3(b)(6).

<sup>17</sup> 15 U.S.C. 78o-3(b)(6).

<sup>18</sup> See Securities Exchange Act Release No. 45991 (May 28, 2002), 67 FR 39476 (June 7, 2002).

No. 1 to that filing submitted to the SEC on May 14, 2002.<sup>19</sup>

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

Within 35 days of the 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.

The NASD has requested accelerated approval of the proposed rule change pursuant to section 19(b)(2) of the Act,<sup>20</sup> because the proposed rule change proposes implementing ADF rules substantially similar to those previously proposed and noticed for comment in the ADF Proposal. The NASD requests that the Commission accelerate the effectiveness of the proposed rule change prior to the 30th day after its publication in the **Federal Register**.

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of 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-2002-97 and should be submitted by August 21, 2002.

<sup>19</sup> Amendment No. 1 is available for inspection and copying in the Commission's Public Reference Room and at the principal office of the NASD.

<sup>20</sup> 15 U.S.C. 78s(b)(2).

### V. Commission Findings and Order Granting Accelerated Approval of the Proposed Rule Change

The Commission finds that the proposed rule change is consistent with the Act and the rules and regulations promulgated thereunder.<sup>21</sup> Specifically, the Commission finds that approval of the proposed rule change is consistent with section 15A(b)(11) of the Act.<sup>22</sup>

Pursuant to section 15A(b)(11) of the Act,<sup>23</sup> the rules of a registered securities association must be designed generally to facilitate the orderly collection, distribution, and publication of quotations. Moreover, these rules must be designed to produce fair and informative quotations and to prevent fictitious or misleading quotations. As the NASD has proposed to sever its corporate relationship with Nasdaq, it is critical that the ADF (in pilot or permanent form) be established, implemented and operating prior to Nasdaq being registered as a national securities exchange. Therefore, the Commission believes that launching the ADF Pilot furthers the public interest by ensuring that continuity in the over-the-counter market is maintained and that the NASD satisfies its statutory obligation to regulate the over-the-counter market.<sup>24</sup>

In addition, in the SuperMontage approval order,<sup>25</sup> the Commission required the NASD to create a facility that "permits NASD members to comply with their obligations under Commission and NASD rules (including Exchange Act Rule 11Ac1-1(c)(5) and Regulation ATS) without participating

<sup>21</sup> In granting accelerated approval of the proposal, the Commission has considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>22</sup> 15 U.S.C. 78o-3(b)(11).

<sup>23</sup> 15 U.S.C. 78o-3(b)(11).

<sup>24</sup> The Commission notes that the launch of the ADF Pilot will result in a new data feed, the Over-the-Counter Montage Data Feed ("OMDF"), being disseminated by the Nasdaq SIP. While the NASD ADF Pilot and Nasdaq operate as the same SRO, the submission of multiple best bid and offers ("BBOs") by the NASD to the Nasdaq SIP is inconsistent with the OTC-UTP Plan. The Commission has addressed this issue in the 13th Amendment to the OTC-UTP Plan. See Securities Exchange Act Release No. 46139 (June 28, 2002), 67 FR 44888 (July 5, 2002). Moreover, the display by market data vendors of either the OMDF or the Nasdaq Quotation Dissemination Service ("NQDS") without the other is inconsistent with the Vendor Display Rule, SEC Rule 11Ac1-2, 17 CFR 240.11Ac1-2. The Commission has addressed this issue in an interpretive guidance letter. See letter to Edward S. Knight, Executive Vice President and General Counsel, Nasdaq, from Robert L.D. Colby, Deputy Director, Division of Market Regulation, Commission, dated July 23, 2002.

<sup>25</sup> Securities Exchange Act Release No. 43863 (January 19, 2001), 66 FR 8020 (January 26, 2001) (File No. SR-NASD-99-53) ("SuperMontage Approval Order").

in the Nasdaq execution facility. The facility will identify through the central processor the identity of the NASD member that is the source of each quote, as is required by Exchange Act Rule 11Ac1-1(b)(1)(ii)." Furthermore, the Commission stated that "[t]he facility will provide a market neutral linkage to the Nasdaq and other marketplaces, but not an execution service."

Thus, approval of the ADF Pilot furthers the obligations of the NASD under the Act and as specified by the Commission in the SuperMontage Approval Order.<sup>26</sup> In particular, the ADF Pilot will provide the Commission with an opportunity to gauge whether the ADF in practice fulfills the NASD's statutory obligations. The Commission emphasizes, however, that approval of this ADF Pilot is not a determination that the conditions of the SuperMontage Approval Order described above have been satisfied.

The Commission finds good cause for granting the NASD's request for approval of the proposed rule change on a pilot basis prior to the thirtieth day after the date of publication in the **Federal Register**. The Commission notes that the substance of the proposal has previously been published for notice and comment as part of the ADF Proposal. The Commission has received 30 comment letters on the ADF Proposal.<sup>27</sup>

<sup>26</sup> Specifically, the Commission conditioned the SuperMontage Approval Order upon the following, which must be implemented prior to or at the same time as the SuperMontage: "(1) That the NASD will offer a quote and trade reporting alternative that satisfies the Order Handling Rules, Regulation ATS, and other regulatory requirements for ATSS, ECNs, and market makers; (2) that NASD quotes disseminated through the exclusive SIP will identify the ATS, ECN, or market maker source of the quote; and (3) that participation in SuperMontage will be entirely voluntary, because NASD quotes will be included in the Nasdaq quotation management system while Nasdaq is the exclusive SIP, but only for display purposes, and the NASD will provide access to its quotes on a market-neutral basis." *Id.* at 8054.

<sup>27</sup> The Commission received 26 comment letters on SR-NASD-2001-90. See Letter from Sol Reicher, Co-Chairman, Amex Specialists Associations; John Hawkey, Chairman, Amex Floor Brokers Association; and James Hyde, Chairman, Amex Options Market Maker Association, writing on behalf of The Member Associations of the American Stock Exchange, dated January 29, 2002 ("Member Associations of the American Stock Exchange Letter"); Letter from Meyer S. Frucher, Chairman and Chief Executive Officer, Philadelphia Stock Exchange, Inc., dated January 24, 2002 ("PHLX Letter #1"); Letter from Meyer S. Frucher, Chairman and Chief Executive Officer, Philadelphia Stock Exchange, Inc., dated February 25, 2002 ("PHLX Letter #2"); Letter from Marc E. Lackritz, President, Securities Industry Association, dated July 24, 2001 ("SIA Letter"); Letter from Michael A. Bird, Chairman, and John C. Giesea, President and CEO, Security Traders Association, dated July 1, 2002 ("STA Letter"); Letter from Darla C. Stuckey, Corporate Secretary, New York Stock Exchange,

Generally, commenters expressed concern with, among other things, (1) the lack of centralized linkage among market participants and an order routing and execution facility;<sup>28</sup> (2) the lack of information regarding technological requirements;<sup>29</sup> (3) whether ITS participation for trading in listed stocks should be mandatory or voluntary;<sup>30</sup> (4) the timing of the launch of the ADF, especially with respect to Nasdaq's pending registration as an exchange and the launch of SuperMontage (several commenters recommended some sort of "test" period before the launch of SuperMontage);<sup>31</sup> and (5) the proposed

Inc., dated February 15, 2002 ("NYSE Letter #1"); Letter from Robert G. Britz, President and Co-Chief Operating Officer, New York Stock Exchange, Inc., dated May 21, 2002 ("NYSE Letter #2"); Letter from Darla C. Stuckey, Corporate Secretary, New York Stock Exchange, Inc., dated July 15, 2002 ("NYSE Letter #3"); Letter from Kevin M. Foley, Bloomberg Tradebook LLC, dated February 7, 2002 ("Bloomberg Letter #1"); Letter from Kevin M. Foley, Bloomberg Tradebook LLC, dated June 28, 2002 ("Bloomberg Letter #2"); Letter from Michael T. Dorsey, Senior Vice President, General Counsel, and Secretary, Knight Trading Group, Inc., dated February 6, 2002 ("Knight Letter"); Letter from William O'Brien, Senior Vice President & General Counsel, Brut, LLC, dated February 13, 2002 ("Brut Letter #1"); Letter from William O'Brien, Senior Vice President & General Counsel, Brut, LLC, dated March 20, 2002 ("Brut Letter #2"); Letter from Douglas M. Atkin, President and Chief Executive Officer, Instinet, dated February 13, 2002 ("Instinet Letter #1"); Letter from Jon Kroeper, First Vice President and Regulatory Policy/Strategy, Instinet, dated July 1, 2002 ("Instinet Letter #2"); Letter from Mark P. Barracca, Corporate Counsel, NexTrade, Inc., dated January 18, 2002 ("NexTrade Letter #1"); Letter from John M. Schaible, President, NexTrade, Inc., dated April 8, 2002 ("NexTrade Letter #2"); Letter from John M. Schaible, President, NexTrade, Inc., dated June 9, 2002 ("NexTrade Letter #3"); Letter from K. Richard B. Niehoff, Chairman, President, and CEO, WEBIXTRADER.COM, dated June 27, 2002 ("Webix Letter"); Letter from Amy Montague, dated June 21, 2002 ("Montague Letter"); Letter from William Joseph, dated June 25, 2002 ("Joseph Letter"); Letter from Jim Hendricks, dated February 21, 2002 ("Hendricks Letter"); Letter from Jim Ryan, dated June 20, 2002 ("Ryan Letter"); Letter from George A. Robles, dated June 15, 2002 ("Robles Letter"); Letter from Ira Rosenbloom, dated June 10, 2002 ("Rosenbloom Letter"); and Letter from John Tarleton, dated June 20, 2002 ("Tarleton Letter"). The Commission received four comment letters on SR-NASD-2002-28. See Letter from William O'Brien, Senior Vice President and General Counsel, Brut LLC, dated March 20, 2002 ("Brut Fee Letter"); Letter from Douglas M. Atkin, President, Chief Executive Officer, Instinet, dated April 1, 2002 ("Instinet Fee Letter"); Letter from Mark P. Barracca, Corporate Counsel, NexTrade, dated April 1, 2002 ("NexTrade Fee Letter"); and Letter from Kevin M. Foley, Bloomberg Tradebook LLC, dated April 2, 2002 ("Bloomberg Fee Letter").

<sup>28</sup> See e.g. NexTrade Letters #1, 2, and 3; SIA Letter; Phlx Letter #2. The Commission also notes that some commenters were not very concerned with the lack of a linkage or execution facility. See e.g. Bloomberg Letter #1; BRUT Letter #1.

<sup>29</sup> See e.g. BRUT Letter #2; NexTrade Letters #1, 2, and 3; Bloomberg Letter #2; Instinet Letter #2.

<sup>30</sup> See e.g. NYSE Letters #1 and 2; Instinet Letter #1; Members Association of the American Stock Exchange Letter; Bloomberg Letter #2.

<sup>31</sup> See e.g. Instinet Letter; SIA Letter; Bloomberg Letter #2; Instinet Letter #2.

fees, including the lack of market data revenue rebates.<sup>32</sup>

A number of commenters criticized the ADF for not providing a central linkage facility operated and funded by the NASD. They argued that the lack of a core ADF linkage would impede access to the quotes displayed in ADF, discouraging ADF participation, and would impose access costs on order routing firms. Other commenters, however, stated that the approach to access relied upon by the NASD—linkages developed by private access providers—encouraged the development of efficient, technologically innovative access services.

After considering the comments, the Commission believes that the NASD's rule-based access solution has the potential to provide effective market-neutral linkages among ADF market participants and between the ADF and other markets. The sharp reduction in communication line costs in recent years and the advent of competing access providers in the equity markets offer the potential for multiple competitive means of access widely available to participants in the market for Nasdaq securities. This approach has been advocated in other market contexts, and the Commission has previously discussed favorably the potential for a private linkage approach.<sup>33</sup>

Moreover, the NASD rules require direct connectivity between ADF participants to be in place before the participants begin quoting, and the NASD plans to review with each ADF participant the extent that other NASD members have connectivity to their quotes. Moreover, the pilot program will give the Commission and the NASD the opportunity to review the practical operation of this access approach and to make changes where necessary to improve access capabilities.

The commenters also raised concerns about the lack of information regarding the requirements for the system. Some of these comments were in fact criticisms of the communications protocols used by the ADF system.

The Commission notes that the NASD made its technical specifications for the ADF available as early as March, 2002. Although these specifications were known in March, few market participants have familiarized themselves with these requirements. Some commenters criticized the ADF

<sup>32</sup> See e.g. Brut Fee Letter; Instinet Fee Letter; NexTrade Fee Letter; Bloomberg Fee Letter.

<sup>33</sup> See Securities Exchange Act Release No. 43084 (July 28, 2000), 65 FR 48406 (August 8, 2000) (File No. S7-16-00) (proposing rules regarding disclosure of order routing and execution practices).

for not employing a FIX protocol. It should be noted that the FIX protocol is not commonly used by other markets at this time. (The NASD has indicated its willingness to develop a FIX interface to the ADF if justified by interest from market participants.)

Commenters also wrote at length about the NASD's proposal to allow ADF quoting participants in listed stocks to choose whether to participate in the Intermarket Trading System. Because the NASD's pilot program is limited to Nasdaq securities, these comments are not germane to the current filing.

Several commenters expressed concern about the commencement of ADF and the need for potential market participants to program and test with the ADF before quoting and trade reporting through the system. The Commission recognizes that, as with any other new system, potential ADF participants must code to the ADF and test their systems before they can begin using the ADF. The Commission notes that the approval of the ADF pilot program is not in itself a determination that the conditions precedent contained in the SuperMontage approval order have been satisfied.

A number of commenters also criticized the ADF as not offering a competitive alternative to Nasdaq because the NASD's fee levels were deemed excessive and because the NASD does not share market data revenues as do Nasdaq and certain other markets. In response, the NASD has proposed a set of fee waivers and discounts to make the ADF more attractive financially, and it intends to review its fees on an ongoing basis as it gains experience with the costs and revenues from operating the ADF. Although the NASD does not intend to share market data revenues, it does not believe that it need do so to offer a useful alternative quoting and trading venue.

The Commission believes that the concerns raised by commenters have been preliminarily addressed, and that the approval of the ADF Pilot will help the Commission evaluate these concerns more fully after practical experience with the ADF. Accordingly, the Commission finds that good cause exists, consistent with sections 15A(b)(11) of the Act,<sup>34</sup> and section 19(b)(2) of the Act<sup>35</sup> to accelerate approval of the proposed rule change prior to the thirtieth day after publication in the **Federal Register**.

<sup>34</sup> 15 U.S.C. 78o-3(b)(11).

<sup>35</sup> 15 U.S.C. 78s(b)(2).



It is therefore ordered, pursuant to section 19(b)(2) of the Act,<sup>36</sup> that the proposed rule change (File No. SR-

<sup>36</sup> 15 U.S.C. 78s(b)(2).

<sup>37</sup> 17 CFR 200.30-3(a)(12).

NASD-2002-97) is approved on a pilot basis to expire at the close of daily operation of the ADF Pilot on April 24, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>37</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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