

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49252; File No. SR-NASD-2004-02]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by National Association of Securities Dealers, Inc. Relating To Amend NASD Rule 4300A To Require an NASD Alternative Display Facility Market Participant To Provide Advance Written Notice Prior To Denying Electronic Access to Its Quote to Any NASD Member

February 13, 2004.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on January 8, 2004 the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. On February 5, 2004, the Commission received Amendment No. 1 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

NASD proposes to amend NASD Rule 4300A to require an Alternative Display Facility ("ADF") Market Participant to provide advance written notice to NASD's ADF Market Operations ("ADF Market Operations") before denying electronic access to its ADF quote to any NASD member in the limited circumstances where a broker-dealer fails to pay contractually obligated costs for access to the ADF Market Participant's quotations.

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

\* \* \* \* \*

#### 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) through (2) No change.

(3) *Provide at least 14 calendar days advance written notice, via facsimile, personal delivery, courier or overnight mail, to NASD Alternative Display Facility Operations before denying any NASD member direct or indirect electronic access, as defined below. The 14-day period begins on the first business day that NASD Alternative Display Facility Operations has receipt of the notice.*

(4) [(3)] [Market Participants shall s]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) through (f) No change.

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

In its filing with the Commission, NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. 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

ADF is a quotation collection, trade comparison, and trade reporting facility developed by NASD in accordance with the Commission's SuperMontage Approval Order<sup>4</sup> and in conjunction with Nasdaq's anticipated registration as a national securities exchange.<sup>5</sup> ADF currently is operating as a pilot until October 26, 2004,<sup>6</sup> and it is anticipated that ADF will continue to operate on a pilot basis until the Commission approves the operation of the ADF on a permanent basis.

ADF provides Market Participants (e.g., ADF-registered market makers or

electronic communications networks) the ability to post quotations in Nasdaq securities and provides all members that participate in the ADF the ability to view quotations and report transactions in Nasdaq securities to the Securities Information Processor ("SIP") for Nasdaq-listed issues for consolidation and dissemination of data to vendors and ADF market participants. ADF also provides for trade comparison through the Trade Reporting and Comparison Service ("TRACS"). ADF further provides for real-time data delivery to NASD for regulatory purposes, including enforcement of firm quote and related rules.

ADF does not provide an order-routing capability. Instead, NASD Rule 4300A requires Market Participants to provide direct electronic access to other Market Participants and to provide to all other NASD members direct electronic access or allow for indirect electronic access to the individual Market Participant's quote. This rule provides the means for ADF Market Participants and other broker/dealers to access ADF quotes and, among other things, meet the firm quote and locked and crossed quotation requirements.

NASD Rule 4300A prohibits Market Participants from in any way discouraging or discriminating against members that wish to reach their quotes. 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 to all broker-dealers seeking such access.<sup>7</sup>

Recently, NASD became aware that an ADF Market Participant denied access to a second ADF Market Participant for allegedly failing to pay contractually obligated costs. This action caused disruption not only for the ADF Market Participant denied access, but also other NASD members that typically accessed the first ADF Market Participant's quote through the second ADF Market Participant's routing system. Although there were other means in place by which an NASD member could access the first ADF Market Participant's quotes, absence of any advance notice of the denial of access caused confusion in the marketplace as members considered how best to access the first ADF Market Participant's quotes by other means.

Accordingly, to maintain market efficiency and prevent such confusion in the future, NASD proposes to amend NASD Rule 4300A to require ADF

<sup>7</sup> See Securities Exchange Act Release No. 46249 (July 24, 2002), 67 FR 49822 (July 31, 2002).

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

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

<sup>3</sup> On February 5, 2004, NASD filed a Form 19b-4, which replaced the original filing in its entirety ("Amendment No. 1").

<sup>4</sup> See Securities Exchange Act Release No. 43863 (January 19, 2001), 66 FR 8020 (January 26, 2001).

<sup>5</sup> See Securities Exchange Act Release No. 44396 (June 7, 2001), 66 FR 31952 (June 13, 2001).

<sup>6</sup> See Securities Exchange Act Release No. 49131 (January 27, 2004), 69 FR 5229 (February 3, 2004).

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

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

## 2. Statutory Basis

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

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

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

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

Written comments were neither solicited nor received.

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

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

(A) by order approve such proposed rule change, or

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

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Comments may also be submitted electronically at the following e-mail address: rule-comments@sec.gov. All comment letters should refer to File No. SR-NASD-2004-02. This file number should be included on the subject line if e-mail is used. To help the Commission process and review comments more efficiently, comments should be sent in hardcopy or by e-mail but not by both methods. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change, as amended, that are filed with the Commission, and all written communications relating to the proposed rule change, as amended, between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD.

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

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

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

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

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

February 17, 2004.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on February 2, 2004, the National Association of Securities Dealers, Inc. ("NASD"), through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), submitted to the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq. On February 6, 2004, Nasdaq submitted Amendment No. 1 to the proposal.<sup>3</sup> On February 10, 2004, Nasdaq filed Amendment No. 2 to the proposal.<sup>4</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

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

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

<sup>3</sup> See letter from John M. Yetter, Associate General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division of Market Regulation ("Division"), Commission, dated February 5, 2004 ("Amendment No. 1"). In Amendment No. 1, Nasdaq amended the proposed rule text to clarify that a resting discretionary order that executes within its discretionary price range is deemed to be the liquidity accessor, unless the incoming order against which it executes is designated "immediate-or-cancel," in which case the incoming order is the liquidity accessor. Nasdaq also clarified the manner that it intends to implement discretionary orders.

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

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