

Notice to Members

APRIL 2005

SUGGESTED ROUTING

Executive Representatives
Legal & Compliance
Market Making
Operations
Senior Management
Trading

KEY TOPICS

Access to Quotations
Alternative Display Facility
Market Regulation

GUIDANCE

Denial of Access Complaints

SEC Approves New Alternative Display Facility (ADF) Pilot Rule Giving NASD Authority to Receive and Review Complaints Alleging Denial of Access to an ADF Market Participant Quote; **Compliance Date: May 26, 2005**

Executive Summary

On March 10, 2005, the Securities and Exchange Commission (SEC) approved on a pilot basis new NASD Rule 4400A, which gives NASD the authority to receive and review complaints against NASD Market Participants alleging denial of access to their quotations in the Alternative Display Facility (ADF). In addition, the rule sets forth procedures for reviewing such complaints and delegates authority to NASD's Market Regulation Committee (MRC) to review denial of access determinations rendered in accordance with Rule 4400A. The new rule can be found in Attachment A and becomes effective on **May 26, 2005**.

Questions/Further Information

Questions or comments concerning this *Notice* may be directed to Chris Stone, Associate Chief Counsel, Transparency Services, at (202) 728-8457; or Philip Shaikun, Associate General Counsel, Regulatory Policy and Oversight, at (202) 728-8451.

Background and Discussion

On July 24, 2002, the SEC approved SR-NASD-2002-97, which authorized NASD to operate the ADF on a pilot basis for nine months.¹ The pilot has since been extended until July 26, 2005.² The ADF is a quotation collection, trade comparison, and trade reporting facility developed by NASD in accordance with the SEC's SuperMontage Approval Order³ and in conjunction with NASDAQ's proposal to register as a national securities exchange.⁴

The ADF does not provide an order routing capability; therefore, NASD Rule 4300A requires an NASD Market Participant to provide direct electronic access to other NASD Market Participants and to provide all other NASD members direct electronic access or allow for indirect electronic access to its quotations in the ADF.

The rule change gives NASD the authority to receive and review complaints against an NASD Market Participant alleging denial of direct or indirect access required by NASD Rule 4300A. The rule change does not include complaints that allege: (1) a denial of direct or indirect access because of non-payment of fees for access to an NASD Market Participant's quotations that are imposed by the NASD Market Participant in accordance with SEC rules and regulations or otherwise; or (2) a specific instance or group of instances over discrete time periods where an NASD Market Participant is alleged not to have not honored its quotation in accordance with applicable SEC and NASD rules with respect to orders received electronically pursuant to NASD Rule 4300A.

The process under Rule 4400A for a proper denial of access complaint is as follows: The complainant is required to file a written complaint with ADF Operations via facsimile, personal delivery, courier, or overnight mail that specifically alleges denial of access to an NASD Market Participant's quotation. The complainant is required to serve a copy of the complaint by the same means on the opposite party in accordance with NASD Rule 9134(b).

An officer designated by a President of NASD or one of its divisions then reviews the denial of access complaint to make a determination on the merits of the complaint. The officer may, at his or her discretion, conduct further investigation before rendering a decision as to whether there has been a denial of access in contravention of Rule 4300A. In the event that the officer determines that there has been such a denial of access, he or she will direct the offending party to provide access to its ADF quotes and may limit participation in the ADF by such party if it does not comply promptly with the directive to provide access. The directive and any action to limit participation in the ADF will become effective and remain in place during the pendency of any further review or appeal.

The rule change also provides for a review of the initial determination by a three-member subcommittee consisting of current or former MRC members. A party seeking such review is required to submit a written appeal to NASD by the close of business on the next business day after receipt of the initial determination and to simultaneously serve a copy of the written appeal to the opposite party. The party seeking review is accorded twenty-four (24) hours, or a longer period determined by NASD staff, after submission of the appeal to provide to NASD and the opposing party any supporting written information concerning the appeal. The opposing party then has the same amount of time to submit written documentation in support of its position. A three-member subcommittee of current or former MRC members will then render a final determination to affirm or reverse the determination of the NASD officer based on the record and any hearing it determines to hold in its discretion.

The rule requires the MRC subcommittee to provide written notification of its decision by the close of business the day following its determination. The decision, including affirmation of any directive to provide access or action to limit participation in the ADF rendered by the NASD officer, is effective upon issuance of the written decision and remains in effect during the pendency of further appeals or other legal proceedings. The MRC subcommittee may not impose any additional sanctions, including monetary fines; its authority is limited to affirming or reversing the determination of the NASD officer.

The MRC decision constitutes final NASD action and can be appealed to the SEC. The decision does not prejudice the rights of the parties to subsequently submit the matter to arbitration or another adjudicatory forum as appropriate. Furthermore, the decision does not operate as an estoppel or otherwise bind NASD in any subsequent disciplinary action or other legal proceeding.

The pilot rule will remain in effect for the duration of the ADF pilot, absent any additional rulemaking action by NASD.

Endnotes

- 1 Exchange Act Release No. 46249 (July 24, 2002), 67 FR 49822 (July 31, 2002).
- 2 Exchange Act Release No. 47633 (April 10, 2003), 68 FR 19043 (April 17, 2003); Exchange Act Release No. 49131 (January 27, 2004), 69 FR 5229 (February 3, 2004); Exchange Act Release No. 50601 (October 28, 2004), 69 FR 64611 (November 5, 2004).
- 3 Exchange Act Release No. 43863 (January 19, 2001), 66 FR 8020 (January 26, 2001) (File No. SR-NASD-99-53).
- 4 Exchange Act Release No. 44396 (June 7, 2001), 66 FR 31952 (June 13, 2001) (File No. 10-131).

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ATTACHMENT A

New language is underlined.

4400A. Review of Direct or Indirect Access Complaints

(a) Authority to Receive Complaints

(1) For the purposes of this Rule, a "direct or indirect access complaint" is a complaint against an NASD Market Participant, as defined in Rule 4300A(d)(4), that alleges a denial or limitation of access in contravention of Rule 4300A.

(2) Any member that wishes to file a direct or indirect access complaint shall submit a written complaint, via facsimile, personal delivery, courier or overnight mail, to ADF Operations and simultaneously serve by the same means the respondent in accordance with Rule 9134(b). Officers of NASD designated by a President of NASD or one of its divisions shall have the authority to review and make a determination regarding direct or indirect access complaints.

(3) Based upon a review of the complaint and such investigation that the officer, in his or her sole discretion, may decide to conduct, the officer shall promptly determine whether there has been a denial of access by the NASD Market Participant. If the officer determines that there has been a denial of access in contravention of Rule 4300A, the officer shall direct the offending party to provide access to its ADF quotes and may limit participation in the ADF by such party if it does not comply promptly with the directive. NASD shall provide to the parties written notification of the determination by the close of business following the day the determination is rendered. The determination shall be sent to the facsimile number listed in the parties' contact questionnaire submitted to NASD pursuant to Article IV, Section 3 of NASD's By-Laws or another contact specifically designated by a party. The determination, and any directive to provide access or action to limit participation in the ADF, shall be effective when issued or as specified, and shall remain in effect during any review or appeal. The determination shall not constitute an estoppel as to NASD nor bind NASD in any subsequent administrative, civil, or disciplinary proceeding.

(b) Procedures for Review of Determinations

(1) Any member that seeks review of a determination issued pursuant to paragraph (a) hereof, shall submit a written appeal setting forth the grounds for such review. The written appeal shall be submitted via facsimile, personal delivery, courier or overnight mail, to NASD and served by the same means on the opposite party, in accordance with Rule 9134(b), by close of the next business day after receipt of the written determination. Written appeals that are not served upon NASD and the opposite party by the close of the next business day after receipt of the written determination will not qualify for further administrative consideration, without prejudice as to the rights of a party to submit the dispute to arbitration or another adjudicatory forum.

(2) Once a written appeal has been received in accordance with subparagraph (b)(1) above:

(A) the party seeking review shall have up to twenty-four (24) hours, or such longer period as specified by NASD staff, to submit to NASD and the opposite party via facsimile, personal delivery, courier or overnight mail, any supporting written information concerning the appeal;

(B) after receipt of the foregoing supporting written information, the party served with the appeal shall have up to twenty-four (24) hours, or such longer period as specified by NASD staff, to submit any relevant written information to NASD and the party seeking review via facsimile, personal delivery, courier or overnight mail;

(C) if the party seeking review fails to serve the opposite party any written information required pursuant to this subparagraph, that party's written complaint will not qualify for further administrative consideration, without prejudice as to the rights of a party to submit the dispute to arbitration or another adjudicatory forum.

(3) Each member and/or person associated with a member involved in the review shall provide NASD with any information that it requests to resolve the matter on a timely basis notwithstanding the time parameters set forth in paragraph (b)(2) above.

(4) All requests for information pursuant to this rule shall be sent by the specified means to a receiving location that, from time to time, may be designated by NASD.

(c) Review by a Subcommittee of the Market Regulation Committee

(1) If a party has applied for review of a determination, and the procedural requirements of subparagraph (b) above have been satisfied, the determination shall be reviewed and a decision rendered by a three-member subcommittee comprised of current or former industry members of NASD's Market Regulation Committee. Upon consideration of the record, and after such hearings as it may in its discretion order, the subcommittee, in accordance with the requirements set forth in Rule 4300A, shall affirm or reverse the determination of the NASD officer pursuant to paragraph (a)(3) above.

(2) The subcommittee shall provide written notification of its determination to the parties by the close of business following the day the determination is rendered. The subcommittee's determination shall not prejudice the rights of a party to submit the dispute to arbitration or another adjudicatory forum. The subcommittee's determination, including affirmation of any directive or action rendered in accordance with paragraph (a)(3), shall be effective when issued or as specified, constitute final NASD action, and remain in effect during any review or appeal. The subcommittee's determination shall not constitute an estoppel as to NASD nor bind NASD in any subsequent administrative, civil, or disciplinary proceeding.