

Barbara Z. Sweeney
Senior Vice President
and Corporate Secretary

December 4, 2003

Ms. Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1001

Re: **File No. SR-NASD-2003-181: Proposed Rule Change To Expressly State
NASD's Authority to Suspend Quotations of ADF Market Participants**

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed please find the above-numbered rule filing. Also enclosed is a 3-1/2" disk containing the rule filing in Microsoft Word 7.0 to facilitate production of the Federal Register release.

If you have any questions, please contact Philip A. Shaikun, Office of General Counsel, Regulatory Policy and Oversight, NASD at (202) 728-8451; e-mail philip.shaikun@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Barbara Z. Sweeney

Enclosures

cc: John Polise

File No. SR-NASD-2003-181
Consists of 15 Pages
December 4, 2003

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C.

Form 19b-4

Proposed Rule Change

by

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Pursuant to Rule 19b-4 under the
Securities Exchange Act of 1934

1. Text of Proposed Rule Change

Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act” or “Act”), the National Association of Securities Dealers, Inc. (“NASD”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to amend Rule 4613A(c) to clarify that NASD may suspend quotations in NASD’s Alternative Display Facility (“ADF”) displayed by any market participant, including an electronic communication network (“ECN”), that are no longer reasonably related to the prevailing market.

The proposed rule change would apply during the time that the NASD ADF operates on a pilot basis. The Commission previously approved the ADF as a nine-month pilot to quote and trade Nasdaq-listed securities only.¹ The Commission subsequently approved an extension of the pilot until January 26, 2004.² As further discussed below, NASD is filing the proposed rule change for immediate effectiveness.

The text of the proposed rule is set forth below. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

4613A. Character of Quotations

(a) through (b) No change.

¹ Exchange Act Release No. 46249 (July 24, 2002), 67 Fed. Reg. 49822 (July 31, 2002).

² Exchange Act Release No. 47633 (April 10, 2003), 68 Fed. Reg. 19043 (April 17, 2003).

(c) Quotations Reasonably Related to the Market

An NASD Market Participant [Registered Reporting ADF Market Maker] shall enter and maintain quotations that are reasonably related to the prevailing market. In the event it appears that an NASD Market Participant's [Registered Reporting ADF Market Maker's] quotations are no longer reasonably related to the prevailing market, NASD may require the [m]NASD Market [maker]Participant to re-enter its quotations. If an NASD Market Participant[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 NASD Market Participant's[market maker's] quotations in one or all securities. For the purposes of this paragraph (c), "NASD Market Participant" shall have the meaning as set forth in Rule 4300A(d)(4).

(1) In the event that an NASD Market Participant's[Registered Reporting ADF Market Maker's] ability to enter or update quotations is impaired, the NASD Market Participant [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 an NASD Market Participant's[Registered Reporting ADF Market Maker's] ability to enter or update quotations is impaired and the NASD Market Participant[Registered Reporting ADF Market Maker] elects to continue to participate through NASD's Alternative Display Facility, the NASD Market Participant[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) through (e) No change.

* * * * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The proposed rule change was approved via unanimous written consent by the Executive Committee of the Board of Governors of NASD on September 15, 2003 and authorized for filing with the SEC. No other action by NASD is necessary for the filing of the proposed rule change. Section 1(a)(iii) of Article VII of NASD By-Laws permits the NASD Board to adopt amendments to NASD Rules without recourse to the membership for approval.

(b) Questions regarding this rule filing may be directed to Philip A. Shaikun, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, NASD, at (202) 728-8451.

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

(a) Purpose

Background

On July 24, 2002, the Commission approved SR-NASD 2002-97, which authorizes NASD to operate the ADF on a pilot basis for nine months, pending the anticipated approval of SR-NASD-2001-90, which proposes to operate the ADF on a permanent basis.³ On April 10, 2003, the Commission approved SR-NASD-2003-53, authorizing extension of the ADF pilot period

³ Exchange Act Release No. 46249 (July 24, 2002), 67 Fed. Reg. 49822 (July 31, 2002).

until January 26, 2004.⁴ As described in detail in SR-NASD-2001-90, the ADF is a quotation collection, trade comparison, and trade reporting facility developed by NASD in accordance with the Commission's SuperMontage Approval Order⁵ and in conjunction with Nasdaq's anticipated registration as a national securities exchange.⁶

For the duration of the pilot period, ADF will provide NASD market participants (e.g., market makers and ECNs) the ability to post quotations in Nasdaq securities and will provide all members that participate in the ADF the ability to view quotations and report transactions in Nasdaq securities to the Exclusive Securities Information Processor ("SIP") for Nasdaq-listed issues for consolidation and dissemination of data to vendors and ADF market participants. The facility also will provide for trade comparison through the Trade Reporting and Comparison Service ("TRACS"). The facility further will provide for real-time data delivery to NASD for regulatory purposes, including enforcement of firm quote and related rules. It is anticipated that the ADF will operate on a pilot basis until the effective date of SR-NASD-2001-90, the approval of which would provide for the operation of the ADF on a permanent basis and an expansion of ADF-eligible securities to include all exchange-listed securities.

Quotations Reasonably Related to the Market

NASD Rule 4613A(c) permits NASD to suspend an ADF market maker's quotations in one or all securities when those quotations are no longer reasonably related to the prevailing market and where that market maker fails to remedy the disparity by re-entering its quotations.

⁴ Exchange Act Release No. 47633 (April 10, 2003), 68 Fed. Reg. 19043 (April 17, 2003).

⁵ Exchange Act Release No. 43863 (January 19, 2001), 66 Fed. Reg. 8020 (January 26, 2001) (File No. SR-NASD-99-53).

⁶ Exchange Act Release No. 44396 (June 7, 2001), 66 Fed. Reg. 31952 (June 13, 2001) (File No. 10-131).

The rule also requires that ADF market makers contact ADF Market Operations and request the withdrawal of their quotes if their ability to enter or update quotes is impaired. In the event that an ADF market maker elects to continue to participate in the ADF under such circumstances, the market maker must execute any orders received against the displayed quote. In accordance with ADF market participant subscriber agreements, as well as NASD's plenary obligations to operate a fair and efficient over-the-counter market, NASD also has maintained similar authority with respect to ECN market participants. This proposed rule change would make express this existing authority and clarify that ECN quotations also are subject to these requirements in such circumstances.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that NASD rules 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. NASD believes that the proposed rule change will foster greater confidence in the markets by making clear that NASD can take appropriate remedial action with regard to quotations by any ADF market participant that may compromise the integrity of the ADF.

4. Self-Regulatory Organization's Statement on Burden on Competition

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, as amended.

5. 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.

6. Extension of Time Period for Commission Action

Not applicable.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

The proposed rule change is effective upon filing pursuant to Section 19(b)(3)(A) of the Act and paragraph (f)(1) of Rule 19b-4 thereunder, in that the proposed rule change constitutes a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule. The proposed rule change only makes express an existing interpretation of Rule 4613A(c) that is consistent with the terms and conditions of ADF market participant subscriber agreements.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

1. Completed notice of proposed rule change for publication in the Federal Register.

Pursuant to the requirements of the Securities Exchange Act of 1934, NASD has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

NASD

BY: _____
Barbara Z. Sweeney
Senior Vice President and Corporate Secretary

Date: December 4, 2003

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-

; File No. SR-NASD-2003-181)

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Expressly State NASD's Authority to Suspend Quotations of ADF Market Participants

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on _____, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. NASD has designated the proposed rule change as concerned solely with administration of the self regulatory organization under Section 19(b)(3)(A)(iii) of the Act³ and Rule 19b-4(f)(3) thereunder,⁴ which renders the proposal effective upon receipt of this filing by the Commission. 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

Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act"), the National Association of Securities Dealers, Inc. ("NASD") is filing with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. § 78s(b)(3)(A)(iii).

⁴ 17 CFR § 240.19b-4(f)(3).

change to amend Rule 4613A(c) to clarify that NASD may suspend quotations in NASD's Alternative Display Facility ("ADF") displayed by any market participant, including an electronic communication network ("ECN"), that are no longer reasonably related to the prevailing market. The proposed rule change would apply during the time that the NASD ADF operates on a pilot basis. The Commission previously approved the ADF as a nine-month pilot to quote and trade Nasdaq-listed securities only.⁵ The Commission subsequently approved an extension of the pilot until January 26, 2004.⁶ The text of the proposed rule is set forth below. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

4613A. Character of Quotations

(a) through (b) No change.

(c) Quotations Reasonably Related to the Market

An NASD Market Participant [Registered Reporting ADF Market Maker] shall enter and maintain quotations that are reasonably related to the prevailing market. In the event it appears that an NASD Market Participant's [Registered Reporting ADF Market Maker's] quotations are no longer reasonably related to the prevailing market, NASD may require the [m]NASD Market [maker]Participant to re-enter its quotations. If an NASD Market Participant[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 NASD Market Participant's[market maker's] quotations in one or all

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⁶ Exchange Act Release No. 47633 (April 10, 2003), 68 Fed. Reg. 19043 (April 17, 2003).

securities. For the purposes of this paragraph (c), “NASD Market Participant” shall have the meaning as set forth in Rule 4300A(d)(4).

(1) In the event that an NASD Market Participant’s[Registered Reporting ADF Market Maker's] ability to enter or update quotations is impaired, the NASD Market Participant [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 an NASD Market Participant’s[Registered Reporting ADF Market Maker's] ability to enter or update quotations is impaired and the NASD Market Participant[Registered Reporting ADF Market Maker] elects to continue to participate through NASD's Alternative Display Facility, the NASD Market Participant[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) through (e) 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 original rule 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

(a) Purpose

Background

On July 24, 2002, the Commission approved SR-NASD 2002-97, which authorizes NASD to operate the ADF on a pilot basis for nine months, pending the anticipated approval of SR-NASD-2001-90, which proposes to operate the ADF on a permanent basis.⁷ On April 10, 2003, the Commission approved SR-NASD-2003-53, authorizing extension of the ADF pilot period until January 26, 2004.⁸ As described in detail in SR-NASD-2001-90, the ADF is a quotation collection, trade comparison, and trade reporting facility developed by NASD in accordance with the Commission's SuperMontage Approval Order⁹ and in conjunction with Nasdaq's anticipated registration as a national securities exchange.¹⁰

For the duration of the pilot period, ADF will provide NASD market participants (e.g., market makers and ECNs) the ability to post quotations in Nasdaq securities and will provide all members that participate in the ADF the ability to view quotations and report transactions in Nasdaq securities to the Exclusive Securities Information Processor ("SIP") for Nasdaq-listed issues for consolidation and dissemination of data to vendors and ADF market participants. The facility also will provide for trade comparison through the Trade Reporting and Comparison Service ("TRACS"). The facility further will provide for real-time data delivery to NASD for

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regulatory purposes, including enforcement of firm quote and related rules. It is anticipated that the ADF will operate on a pilot basis until the effective date of SR-NASD-2001-90, the approval of which would provide for the operation of the ADF on a permanent basis and an expansion of ADF-eligible securities to include all exchange-listed securities.

Quotations Reasonably Related to the Market

NASD Rule 4613A(c) permits NASD to suspend an ADF market maker's quotations in one or all securities when those quotations are no longer reasonably related to the prevailing market and where that market maker fails to remedy the disparity by re-entering its quotations. The rule also requires that ADF market makers contact ADF Market Operations and request the withdrawal of their quotes if their ability to enter or update quotes is impaired. In the event that an ADF market maker elects to continue to participate in the ADF under such circumstances, the market maker must execute any orders received against the displayed quote. In accordance with ADF market participant subscriber agreements, as well as NASD's plenary obligations to operate a fair and efficient over-the-counter market, NASD also has maintained similar authority with respect to ECN market participants. This proposed rule change would make express this existing authority and clarify that ECN quotations also are subject to these requirements in such circumstances.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that NASD rules 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. NASD believes that the

proposed rule change will foster greater confidence in the markets by making clear that NASD can take appropriate remedial action with regard to quotations by any ADF market participant that may compromise the integrity of the ADF.

(B) Self-Regulatory Organization's Statement on Burden on Competition

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, as amended.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule

Written comments were neither solicited nor received.

III. DATE OF EFFECTIVENESS OF THE PROPOSED RULE CHANGE AND TIMING FOR COMMISSION ACTION

The proposed rule change is effective upon filing pursuant to Section 19(b)(3)(A) of the Act and paragraph (f)(1) of Rule 19b-4 thereunder, in that the proposed rule change constitutes a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule. The proposed rule change only makes express an existing interpretation of Rule 4613A(c) that is consistent with the terms and conditions of ADF market participant subscriber agreements.

At any time within 60 days of this filing, the Commission may summarily abrogate this proposal if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. 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 the file number in the caption above and should be submitted by [insert date 21 days from the date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30-3(a)(12).

Margaret H. McFarland
Deputy Secretary