

January 26, 2004

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-2004-012 - Proposed Rule Change To Extend Operation of NASD's Alternative Display Facility as a Temporary Pilot**

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 Stephanie Dumont, Office of General Counsel, NASD, at (202) 728-8176; e-mail [Stephanie.Dumont@nasd.com](mailto:Stephanie.Dumont@nasd.com); or Philip Shaikun, Office of General Counsel, NASD, Regulatory Policy and Oversight, at (202) 728-8451; e-mail [Philip.Shaikun@nasd.com](mailto:Philip.Shaikun@nasd.com). The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Barbara Z. Sweeney  
Senior Vice President  
and Corporate Secretary

Enclosures

File No. SR-NASD-2004-012  
Consists of 16 Pages  
January 26, 2004

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C.

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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

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”), the National Association of Securities Dealers, Inc. (“NASD” or “Association”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to extend for nine months the operation of NASD’s Alternative Display Facility (“ADF”) on a pilot basis. The ADF pilot program, as approved by the SEC on July 24, 2002 and extended on April 17, 2003, will expire on January 26, 2004. The pilot permits members to quote and trade only Nasdaq-listed securities on or through the ADF.

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

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**4000A. NASD Alternative Display Facility**

**4100A. General**

NASD Alternative Display Facility (“ADF”) is the facility to be operated by NASD on a 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 [January 26, 2004] October 26, 2004.

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(b) Not applicable.

(c) Not Applicable.

2. Procedures of the Self-Regulatory Organization

(a) The original proposed rule change, with the exceptions of proposed Rule 4300A and proposed Rule 7000A Series, was approved by the Board of Directors of NASD Regulation, Inc. ("NASD Regulation") at its meeting on July 25, 2001 and authorized for filing with the SEC. Counsel for The Nasdaq Stock Market ("Nasdaq") and NASD Dispute Resolution were provided an opportunity to consult with respect to the proposed rule change, pursuant to the Plan of Allocation and Delegation of Functions by NASD to its Subsidiaries ("Delegation Plan"). The Board of Governors of NASD, Inc. reviewed and approved the proposed rule change, with the exceptions of the proposed Rule 4300A and the proposed Rule 7000A Series, at its meeting on July 26, 2001. NASD Board reviewed and approved the Rule 4300A Series at its December 6, 2001 meeting. The Executive Committee of the NASD Board of Governors reviewed and approved proposed rule changes relating to the proposed Rule 7000A at its meeting on February 14, 2002. NASD Conflict Committee of the NASD Board of Governors also reviewed and approved proposed rule changes relating to the Rule 7000A Series at its meeting on July 22, 2002. The Executive Committee reviewed and approved amendments to the Rule 7000A Series at its meeting on December 6, 2002, and the NASD Board of Governors approved the proposed rule change at its January 23, 2003 meeting. Amendments to Rules 4300A(f), 4613A(e)(1) and 4619A were approved via unanimous written consent by the Executive Committee 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 NASD Board to adopt amendments to NASD Rules without recourse to the membership for approval.

The proposed rule change will become effective upon filing, will be implemented at the close of business on January 26, 2004, and will expire on October 26, 2004.

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

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

(a) Purpose

On July 24, 2002, the Commission approved SR-NASD-2002-97<sup>1</sup>, 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. The Commission subsequently approved SR-NASD-2003-067, an extension of the pilot until January 26, 2004.<sup>2</sup> 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 Order<sup>3</sup> and in conjunction with Nasdaq's anticipated registration as a national securities exchange.<sup>4</sup> In addition, since the Commission gave its initial approval to the ADF pilot,

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

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

<sup>3</sup> Exchange Act Release No. 43863 (January 19, 2001), 66 Fed. Reg. 8020 (January 26, 2001) (File No. SR-NASD-99-53).

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

NASD has filed several other ADF-related rule change proposals, some of which are effective and have been incorporated into the operation and administration of the pilot.<sup>5</sup>

As proposed in SR-NASD-2001-90, the ADF would provide market participants the ability to quote and trade Nasdaq and exchange-listed securities. The current ADF pilot program, however, permits operation of the ADF with respect to Nasdaq securities only. This is because several regulatory issues relating to the trading of exchange-listed securities on the ADF have not been resolved.

The ADF has been operating successfully during the pilot period. The SEC acknowledged this fact when it approved the launch of SuperMontage, stating that the ADF met the conditions set forth in its SuperMontage Approval Order to provide an alternative quotation collection, trade comparison and trade reporting facility. The ADF has since continued to honor those conditions. Meanwhile, the issues related to trading exchange-listed securities – and by extension, approval of the operation of ADF on a permanent basis – remain unresolved. Accordingly, NASD believes it is appropriate to

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<sup>5</sup> On January 30, 2003, NASD filed proposed rule change SR-NASD-2003-009 to revise the transaction and quotation-related fees applicable to ADF activity during the pilot program. The rule change proposal became effective upon filing, with an implementation date of February 17, 2003. On January 6, 2004, the Commission granted accelerated approval to SR-NASD-2003-145, a proposal to amend the NASD ADF pilot rules to give jurisdiction to a three-member subcommittee of NASD's Market Regulation Committee (MRC) to review system outage determinations under Rule 4300A(f) and excused withdrawal denials under Rule 4619A. The rule change proposal became effective contemporaneous with the Commission's approval. On December 4, 2003, NASD filed for immediate effectiveness a proposed rule change to amend Rule 4613A(c) to clarify that NASD may suspend quotations in ADF displayed by any market participant, including an ECN, that are no longer reasonably related to the prevailing market.

Additionally, NASD has pending with the Commission two other rule change proposals. On November 25, 2003, NASD filed with the Commission SR-NASD-2003-175, a rule change proposal to repeal Rule 4613A(e)(1), which requires members that display priced quotations for a Nasdaq security in two or more market centers to display the same priced quotations for that security in each market center. And on January 7, 2004, NASD filed with the Commission SR-NASD-2004-004, a proposed rule change to amend NASD Rule 4300A to require an ADF Market Participant to provide advance written notice to NASD's 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 Market Participant's quotations.

extend the pilot period for ADF trading in Nasdaq securities - until October 26, 2004 or until approval of SR-NASD-2001-90.

(b) Statutory Basis

The rule proposal is consistent with Section 15A(b)(6) of the Exchange Act that requires an Association to have rules that prevent fraudulent and manipulative acts, promote just and equitable principles of trade, 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, this rule proposal is consistent with Section 15A(b)(6) because it does not permit unfair discrimination between customers, issuers, brokers, or dealers, fix minimum profits, impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by members, or regulate matters not related to the purposes of the Act or the administration of NASD.

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 on this proposed rule change were neither solicited nor received. Written comments, however, were solicited on rule change proposals SR-NASD-2001-90 and SR-NASD-2002-28, the underlying rule filings to SR-NASD-2002-97 and SR-NASD-2003-067, and SR-2003-009, respectively. 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. NASD responded to the comments received in response to SR-NASD-2002-28 in its Amendment No. 1 to that filing submitted to the SEC on May 14, 2002.

6. Extension of Time Period for Commission Action

NASD does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.

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 has been filed by NASD as a “non-controversial” rule change and is effective upon filing pursuant to Section 19(b)(3)(A) of the Act and paragraph (f)(6) of Rule 19b-4 thereunder,<sup>6</sup> in that the proposed rule change does not significantly affect the protection of investors or the public interest and does not impose any significant burden on competition. NASD requested that the Commission waive the written notice of its intent to file the proposed rule change set forth in Rule 19b-4(f)(6)(iii). In addition, NASD has requested that the Commission waive the requirement that the rule change not become operative for 30 days after the date of the filing, as set forth in Rule 19b-4(f)(6)(iii), to prevent the current ADF pilot program from lapsing. Therefore, the proposed rule change is effective upon filing pursuant to Section 19(b)(3)(A) of the Exchange Act and Rule 19b-4(f)(6) thereunder.

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

Not applicable.

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<sup>6</sup> 17 CFR § 240.19b-4(f)(6).



9. Exhibits

Exhibit 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, INC.

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

Date: January 26, 2004

**EXHIBIT 1**

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34- ; File No. SR-NASD-2004-012)

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of  
Proposed Rule Change by National Association of Securities Dealers, Inc. To Extend  
Operation of NASD's Alternative Display Facility on a Pilot Basis

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 April 7, 2003, 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 constituting a "non-controversial" rule change under paragraph (f)(6) of Rule 19b-4 under the Act,<sup>3</sup> 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

NASD is proposing to extend for nine months the operation of NASD's Alternative Display Facility ("ADF") on a pilot basis. The ADF pilot program, as approved by the SEC on July 24, 2002, will expire on April 24, 2003. The pilot permits members to quote and trade only Nasdaq-listed securities on or through the ADF. In

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

<sup>2</sup> 17 CFR § 240.19b-4.

<sup>3</sup> 17 CFR § 240.19b-4.

addition, the proposed rule change would amend Rule 4613A to clarify that ADF market participants must have in close proximity to their ADF Facility terminal at which they make a market in a Nasdaq security quotation data from all markets trading Nasdaq securities.

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

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**4000A. NASD Alternative Display Facility**

**4100A. General**

NASD Alternative Display Facility (“ADF”) is the facility to be operated by NASD on a 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 [January 26, 2004] October 26, 2004.

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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

(a) Purpose

On July 24, 2002, the Commission approved SR-NASD-2002-97<sup>4</sup>, 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. The Commission subsequently approved SR-NASD-2003-067, an extension of the pilot until January 26, 2004.<sup>5</sup> 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 Order<sup>6</sup> and in conjunction with Nasdaq's anticipated registration as a national securities exchange.<sup>7</sup> In addition, since the Commission gave its initial approval to the ADF pilot, NASD has filed several other ADF-related rule change proposals, some of which are effective and have been incorporated into the operation and administration of the pilot.<sup>8</sup>

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<sup>4</sup> Exchange Act Release No. 46249 (July 24, 2002), 67 Fed. Reg. 49822 (July 31, 2002).

<sup>5</sup> Exchange Act Release No. 47633 (April 10, 2003), 68 Fed. Reg. 19043 (April 17, 2003).

<sup>6</sup> Exchange Act Release No. 43863 (January 19, 2001), 66 Fed. Reg. 8020 (January 26, 2001) (File No. SR-NASD-99-53).

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<sup>8</sup> On January 30, 2003, NASD filed proposed rule change SR-NASD-2003-009 to revise the transaction and quotation-related fees applicable to ADF activity during the pilot program. The rule change proposal became effective upon filing, with an implementation date of February 17, 2003. On January 6, 2004, the Commission granted accelerated approval to SR-NASD-2003-145, a proposal to amend the NASD ADF pilot rules to give jurisdiction to a three-member subcommittee of NASD's Market Regulation Committee (MRC) to review system outage determinations under Rule 4300A(f) and excused withdrawal denials under Rule 4619A. The rule

As proposed in SR-NASD-2001-90, the ADF would provide market participants the ability to quote and trade Nasdaq and exchange-listed securities. The current ADF pilot program, however, permits operation of the ADF with respect to Nasdaq securities only. This is because several regulatory issues relating to the trading of exchange-listed securities on the ADF have not been resolved.

The ADF has been operating successfully during the pilot period. The SEC acknowledged this fact when it approved the launch of SuperMontage, stating that the ADF met the conditions set forth in its SuperMontage Approval Order to provide an alternative quotation collection, trade comparison and trade reporting facility. The ADF has since continued to honor those conditions. Meanwhile, the issues related to trading exchange-listed securities – and by extension, approval of the operation of ADF on a permanent basis – remain unresolved. Accordingly, NASD believes it is appropriate to extend the pilot period for ADF trading in Nasdaq securities - until October 26, 2004 or until approval of SR-NASD-2001-90.

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change proposal became effective contemporaneous with the Commission's approval. On December 4, 2003, NASD filed for immediate effectiveness a proposed rule change to amend Rule 4613A(c) to clarify that NASD may suspend quotations in ADF displayed by any market participant, including an ECN, that are no longer reasonably related to the prevailing market.

Additionally, NASD has pending with the Commission two other rule change proposals. On November 25, 2003, NASD filed with the Commission SR-NASD-2003-175, a rule change proposal to repeal Rule 4613A(e)(1), which requires members that display priced quotations for a Nasdaq security in two or more market centers to display the same priced quotations for that security in each market center. And on January 7, 2004, NASD filed with the Commission SR-NASD-2004-004, a proposed rule change to amend NASD Rule 4300A to require an ADF Market Participant to provide advance written notice to NASD's 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 Market Participant's quotations.

(b) Statutory Basis

The rule proposal is consistent with Section 15A(b)(6) of the Exchange Act that requires an Association to have rules that prevent fraudulent and manipulative acts, promote just and equitable principles of trade, 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, this rule proposal is consistent with Section 15A(b)(6) because it does not permit unfair discrimination between customers, issuers, brokers, or dealers, fix minimum profits, impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by members, or regulate matters not related to the purposes of the Act or the administration of NASD.

(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 Change Received from Members, Participants, or Others

Written comments on this proposed rule change were neither solicited nor received. Written comments, however, were solicited on rule change proposals SR-NASD-2001-90 and SR-NASD-2002-28, the underlying rule filings to SR-NASD-2002-97 and SR-2003-009, respectively. 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. NASD responded to the comments received in response to SR-

NASD-2002-28 in its Amendment No. 1 to that filing submitted to the SEC on May 14, 2002.

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

The proposed rule change has been filed by NASD as a “non-controversial” rule change and is effective upon filing pursuant to Section 19(b)(3)(A) of the Act and paragraph (f)(6) of Rule 19b-4 thereunder,<sup>9</sup> in that the proposed rule change does not significantly affect the protection of investors or the public interest and does not impose any significant burden on competition. NASD requested that the Commission waive the written notice of its intent to file the proposed rule change set forth in Rule 19b-4(f)(6)(iii). In addition, NASD has requested that the Commission waive the requirement that the rule change not become operative for 30 days after the date of the filing, as set forth in Rule 19b-4(f)(6)(iii), to prevent the current ADF pilot program from lapsing. The Commission finds good cause for the proposed rule change to become operative prior to the 30th day after the date of publication of notice of filing thereof because the proposed rule change is to prevent the current ADF pilot program from lapsing.

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.

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to NASD

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<sup>9</sup> 17 CFR § 240.19b-4(f)(6).

and, in particular, the requirements of Section 15A and the rules and regulations thereunder.

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. Comments may also be submitted electronically at the following e-mail address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov). All comment letters should refer to File No. SR- NASD-2004-012. This file number should be included on the subject line if e-mail is used. To help us 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 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 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].

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change be, and hereby is, approved.



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