

January 7, 2004

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-2004-002 - Amendments to Alternative Display Facility Rules to Require Advance Written Notice of Denial of Direct or Indirect Electronic Access

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, Regulatory Policy and Oversight, NASD, at (202) 728-8176; e-mail stephanie.dumont@nasd.com or Patricia M. Albrecht, Office of General Counsel, Regulatory Policy and Oversight, NASD, at (202) 728-8026; e-mail patricia.albrecht@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-2004-002
Consists of 14 Pages
January 7, 2004

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

(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”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to amend NASD Rule 4300A to require an Alternative Display Facility (“ADF”) Market Participant to provide advance written notice to NASD’s Alternative Display Facility 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 Market Participant’s quotations. Below is the text of the proposed rule change. Proposed new language is underlined; 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.

~~(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.

* * * * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The proposed rule change was approved by the Conflict Committee of the Board of Governors of NASD, Inc. on December 12, 2003, which authorized the filing of the rule change with the SEC. No other action by NASD is necessary for the filing of the proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the NASD Board of Governors to adopt amendments to NASD Rules without recourse to the membership for approval.

NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be no later than 30 days following publication of the Notice to Members announcing Commission approval.

(b) Questions regarding this rule filing may be directed to Stephanie Dumont, Associate Vice President and Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, NASD, at (202) 728-8176 or Patricia M. Albrecht, Assistant General Counsel, Office of General Counsel, Regulatory Policy and Oversight, NASD, at (202) 728-8026.

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

(a) Purpose

The ADF is a quotation collection, trade comparison, and trade reporting facility developed by NASD in accordance with the SEC's SuperMontage Approval Order¹ and in conjunction with Nasdaq's anticipated registration as a national securities exchange.² The ADF currently is operating as a pilot until January 26, 2004,³ and it is anticipated that the ADF will continue to operate on a pilot basis until the SEC 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. The facility also provides for trade comparison through the Trade Reporting and Comparison Service (TRACS). The facility further provides for real-time data delivery to NASD for regulatory purposes, including enforcement of firm quote and related rules.

The ADF does not provide an order-routing capability. Instead, 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

¹ Exchange Act Release No. 43863 (January 19, 2001), 66 Fed. Reg. 8020 (January 26, 2001) (File No. SR-NASD-99-53).

² Exchange Act Release No. 44396 (June 7, 2001), 66 Fed. Reg. 31952 (June 13, 2001) (File No. 10-131).

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.

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.⁴

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 is proposing to amend Rule 4300A to require ADF 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

³ Exchange Act Release No. 47633 (April 10, 2003), 68 Fed. Reg. 19043 (April 17, 2003).

⁴ See Exchange Act Release No. 46249 (July 24, 2002); 67 Fed. Reg. 49822 (July 31, 2002).

member. 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.

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.

(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'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 facilitating market efficiency and reducing potential confusion for market participants.

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

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)

Not applicable.

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, INC.

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

Date: January 7, 2004

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-NASD-2004-002)

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Amendments to Alternative Display Facility Rules to Require Advance Written Notice of Denial of Direct or Indirect Electronic Access

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“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. 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 amend NASD Rule 4300A to require an Alternative Display Facility (“ADF”) Market Participant to provide advance written notice to NASD’s Alternative Display Facility 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 Market Participant’s quotations. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

* * * * *

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.

~~(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.

* * * * *

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

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 anticipated registration as a national securities exchange.⁴ The ADF currently is operating as a pilot until January 26, 2004,⁵ and it is anticipated that the ADF will continue to operate on a pilot basis until the SEC approves the operation of the ADF on a permanent basis.

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The ADF does not provide an order-routing capability. Instead, 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

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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.

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.⁶

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 is proposing to amend Rule 4300A to require ADF 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

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member. 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.

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, 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 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 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 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 is consistent with the act. 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. All comment letters should refer to File No. SR- NASD-2004-002. 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].

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