

July 13, 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 – Amendment No. 2

Dear Ms. England:

To address SEC staff concerns, NASD hereby submits Amendment No. 2 to SR-NASD-2004-002 (the “rule filing”). The attached proposed rule language replaces the proposed rule language filed with the SEC on February 4, 2004 and incorporates the amendment described herein.

NASD is amending the proposed rule text to clarify that, in submitting a notice to NASD under the proposed rule change, a Market Participant must have a good faith belief that its denial of access is appropriate and does not violate any NASD rules or the federal securities laws. In this regard, NASD also is amending the rule text to clarify that a Market Participant may deny access to its quotes only in the limited circumstances where a broker-dealer fails to pay contractually obligated costs for access to the quotes.¹ Because under current SEC rules, only electronic communications networks (“ECNs”) may charge a post-transaction fee for execution against their displayed quotation (i.e., an access fee),² only Market Participants that are ECNs would be permitted to deny access under such circumstances.

Additionally, NASD is clarifying that the publication of a Market Participant’s intent to deny access will have no bearing on the merits of any claim between the Market Participant and any affected broker-dealer, nor will it insulate the Market Participant from liability for violations of NASD rules or the federal securities laws, such as SEC Rule 11Ac1-1. If NASD believes that a Market Participant has improperly denied a broker-dealer access to its quotes, the Market Participant would not have met the terms of Rule 4300A and therefore would be in violation of that provision and would not be permitted to continue quoting on the ADF.

¹ See Exchange Act Rel. No. 46249 (July 24, 2002), 67 FR 49822 (July 31, 2002).

² See Letter dated August 6, 1998 from Robert Colby, Deputy Director, Division of Market Regulation, SEC, to Louis B. Todd, Jr., J.C. Bradford & Co.

Finally, NASD is amending the proposal to remove the requirement that Market Participants provide notice with respect to a denial of access for indirect access. Because Market Participants are not permitted to look through their order flow to identify or discriminate against a source of the order flow via indirect access, Market Participants are not permitted to deny access in such a manner.

Accordingly, NASD is amending proposed Rule 4300A, as set forth in Amendment No. 1, as follows (additions are underlined; deletions are bracketed):

(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. An ECN is the only Market Participant that may lawfully deny access to its quotes, and an ECN may only do so in the limited circumstance where a broker-dealer fails to pay contractually obligated costs for access to the ECN's quotes. The notice provided hereunder must be based on the good faith belief of a Market Participant that such denial of access is appropriate and does not violate any of the Market Participant's obligations under NASD rules or the federal securities laws. Further, any notification or publication of a Market Participant's intent to deny access will have no bearing on the merits of any claim between the Market Participant and any affected broker-dealer, nor will it insulate the Market Participant from liability for violations of NASD rules or the federal securities laws, such as SEC Rule 11Ac1-1. The 14-day period begins on the first business day that NASD Alternative Display Facility Operations has receipt of the notice.

(4) No change.

(b) through (f) No change.

If you have any questions, please do not hesitate to call me at (202) 728-8026.

Very truly yours,

Patricia M. Albrecht

Attachment A
Proposed Rule Language, as amended by
Amendment No. 2 to SR-NASD-2004-002

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 electronic access as defined below. An ECN is the only Market Participant that may lawfully deny access to its quotes, and an ECN may only do so in the limited circumstance where a broker-dealer fails to pay contractually obligated costs for access to the ECN's quotes. The notice provided hereunder must be based on the good faith belief of a Market Participant that such denial of access is appropriate and does not violate any of the Market Participant's obligations under NASD rules or the federal securities laws. Further, any notification or publication of a Market Participant's intent to deny access will have no bearing on the merits of any claim between the Market Participant and any affected broker-dealer, nor will it insulate the Market Participant from liability for violations of NASD rules or the federal securities laws, such as SEC Rule 11Ac1-1. The 14-day

period begins on the first business day that NASD Alternative Display Facility Operations has receipt of the notice.

(4)[3] 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.