

July 22, 2004

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

**RE: SR-NASD-2004-112 - Proposed Extension of the Pilot relating to Manning
Price-Improvement Standards for Decimals**

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 Word 7.0 to facilitate production of the Federal Register release.

If you have any questions, please contact Andrea Orr, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8156; e-mail andrea.orr@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-2004-112
Consists of 12 Pages
July 22, 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”),¹ the National Association of Securities Dealers, Inc. (“NASD”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposal to extend retroactively to July 1, 2004, and prospectively through December 31, 2004, the current pilot price-improvement standards for decimalized securities contained in NASD Interpretive Material 2110-2 - Trading Ahead of Customer Limit Order (“Manning Interpretation” or “Manning”). Without such an extension, these standards would have expired on June 30, 2004. NASD does not propose to make any substantive changes to the pilot; the only changes are making this proposal effective on a retroactive basis to July 1, 2004 and extending the pilot’s expiration date to December 31, 2004.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The NASD Board of Governors reviewed the proposed rule change at its meeting on January 27, 2000, 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)(iii) of Article VII of the NASD By-Laws permit the NASD Board of Governors to adopt amendments to NASD Rules without recourse to the membership for approval.

(b) Questions regarding this rule filing may be directed to Andrea Orr, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8156.

¹ 15 U.S.C. 78s(b)(1).

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

(a) Purpose

NASD's Manning Interpretation requires NASD member firms to provide a minimum level of price improvement to incoming orders in NMS and SmallCap securities if the firm chooses to trade as principal with those incoming orders at prices superior to customer limit orders they currently hold. If a firm fails to provide the minimum level of price improvement to the incoming order, the firm must execute its held customer limit orders. Generally, if a firm fails to provide the requisite amount of price improvement and also fails to execute its held customer limit orders, it is in violation of the Manning Interpretation.

On April 6, 2001,² the Commission approved, on a pilot basis, price-improvement standards for decimalized securities contained in Manning, which added the following language to IM-2110-2:

For Nasdaq securities authorized for trading in decimals pursuant to the Decimals Implementation Plan For the Equities and Options Markets, the minimum amount of price improvement necessary in order for a market maker to execute an incoming order on a proprietary basis in a security trading in decimals when holding an unexecuted limit order in that same security, and not be required to execute the held limit order, is as follows:

- 1) For customer limit orders priced **at or inside** the best inside market displayed in Nasdaq, the minimum amount of price improvement required is \$0.01; and

² See SEC Release No. 34-44165 (April 6, 2001); 66 FR 19268 (April 13, 2001).

- 2) For customer limit orders priced **outside** the best inside market displayed in Nasdaq, the market maker must price improve the incoming order by executing the incoming order at a price at least equal to the next superior minimum quotation increment in Nasdaq (currently \$0.01).³

Since approval, these standards have operated on a pilot basis which terminated on June 30, 2004.⁴ After consultation with SEC staff, NASD has determined to seek an extension of its current Manning pilot until December 31, 2004. NASD believes that such an extension provides for an appropriate continuation of the current Manning price-improvement standard while the Commission continues to analyze the issues related to customer limit order protection in a decimalized environment. NASD also is seeking to make this proposal effective on a retroactive basis to July 1, 2004. NASD is not proposing any other changes to the pilot at this time.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁵ 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. NASD believes that the proposed rule change will improve treatment of customer limit orders and enhance the integrity of the market.

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

³ Pursuant to the terms of the Decimals Implementation Plan for the Equities and Options Markets, the minimum quotation increment for Nasdaq securities (both National Market and SmallCap) at the outset of decimal pricing is \$0.01. As such, Nasdaq displays priced quotations to two places beyond the decimal point (to the penny). Quotations submitted to Nasdaq that do not meet this standard are rejected by Nasdaq systems. See SR-NASD-01-07; SEC Release No. 34-43876 (January 23, 2001), 66 FR 8251 (January 30, 2001).

⁴ See SEC Release No. 34-48876 (December 4, 2003), 68 FR 69103 (December 11, 2003).

⁵ 15 U.S.C. 78o-3(6).

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)

NASD requests the Commission to find good cause pursuant to Section 19(b)(2) of the Act for approving the proposed rule change prior to the 30th day after its publication in the Federal Register.

To allow the current pilot program to operate without interruption, NASD requests the Commission accelerate the effectiveness of the proposed rule change prior to the 30th day after its publication in the Federal Register.

8. Proposed Rule Change Based on rules of Another Self-Regulatory Organization 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: July 22, 2004

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-NASD-2004-112)

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by National Association of Securities Dealers, Inc. to the Pilot Relating to Manning Price-Improvement Standards for Decimals

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. For the reasons discussed below, the Commission is granting accelerated approval of the proposed rule change.

I. Self-Regulatory Organization’s Statement of the Terms of the Substance of the Proposed Rule Change

Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),³ the National Association of Securities Dealers, Inc. (“NASD”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposal to extend retroactively to July 1, 2004, and prospectively through December 31, 2004, the current pilot price-improvement standards for decimalized securities contained in NASD Interpretive Material 2110-2 - Trading Ahead of Customer Limit Order (“Manning Interpretation” or “Manning”). Without such an extension, these standards would have expired on June 30, 2004. NASD does

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR § 240.19b-4.

³ 15 U.S.C. 78s(b)(1).

not propose to make any substantive changes to the pilot; the only changes are making this proposal effective on a retroactive basis to July 1, 2004 and extending the pilot's expiration date to December 31, 2004.

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

In its original 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

NASD's Manning Interpretation requires NASD member firms to provide a minimum level of price improvement to incoming orders in NMS and SmallCap securities if the firm chooses to trade as principal with those incoming orders at prices superior to customer limit orders they currently hold. If a firm fails to provide the minimum level of price improvement to the incoming order, the firm must execute its held customer limit orders. Generally, if a firm fails to provide the requisite amount of price improvement and also fails to execute its held customer limit orders, it is in violation of the Manning Interpretation.

On April 6, 2001,⁴ the Commission approved, on a pilot basis, price-improvement standards for decimalized securities contained in Manning, which added the following language to IM-2110-2:

For Nasdaq securities authorized for trading in decimals pursuant to the Decimals Implementation Plan For the Equities and Options Markets, the minimum amount of price improvement necessary in order for a market maker to execute an incoming order on a proprietary basis in a security trading in decimals when holding an unexecuted limit order in that same security, and not be required to execute the held limit order, is as follows:

- 1) For customer limit orders priced **at or inside** the best inside market displayed in Nasdaq, the minimum amount of price improvement required is \$0.01; and
- 2) For customer limit orders priced **outside** the best inside market displayed in Nasdaq, the market maker must price improve the incoming order by executing the incoming order at a price at least equal to the next superior minimum quotation increment in Nasdaq (currently \$0.01).⁵

Since approval, these standards have operated on a pilot basis which terminated on June 30, 2004.⁶ After consultation with SEC staff, NASD has determined to seek an extension of its current Manning pilot until December 31, 2004. NASD believes that such an extension provides for an appropriate continuation of the current Manning price-improvement standard while the

⁴ See SEC Release No. 34-44165 (April 6, 2001); 66 FR 19268 (April 13, 2001).

⁵ Pursuant to the terms of the Decimals Implementation Plan for the Equities and Options Markets, the minimum quotation increment for Nasdaq securities (both National Market and SmallCap) at the outset of decimal pricing is \$0.01. As such, Nasdaq displays priced quotations to two places beyond the decimal point (to the penny). Quotations submitted to Nasdaq that do not meet this standard are rejected by Nasdaq systems. See SR-NASD-01-07; SEC Release No. 34-43876 (January 23, 2001), 66 FR 8251 (January 30, 2001).

⁶ See SEC Release No. 34-48876 (December 4, 2003), 68 FR 69103 (December 11, 2003).

Commission continues to analyze the issues related to customer limit order protection in a decimalized environment. NASD also is seeking to make this proposal effective on a retroactive basis to July 1, 2004. NASD is not proposing any other changes to the pilot at this time.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁷ 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. NASD believes that the proposed rule change will improve treatment of customer limit orders and enhance the integrity of the market.

(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

NASD has requested that the Commission find good cause pursuant to Section 19(b)(2) of the Act for approving the proposed pilot extension prior to the 30th day after publication in the Federal Register. The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the NASD and, in

⁷ 15 U.S.C. 78o-3(6).

particular, the requirements of Section 15A and the rules and regulations thereunder. 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 will allow the current pilot program to operate without interruption.

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-2004-112. 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