

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-52122; File No. SR-NASD-2005-092)

July 25, 2005

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

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 July 20, 2005, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("SEC" or the "Commission") the proposed rule change as described in Items I and II below, which items have been prepared by NASD. NASD has designated the proposed rule change as a "non-controversial" rule change pursuant to Rule 19b-4(f)(6) under the Act,<sup>3</sup> which renders the proposal effective upon filing with 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, to April 26, 2006, 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, January 26, 2004, and October 26, 2004, will expire on July 26, 2005. The pilot permits members to quote and trade only Nasdaq-listed securities on or through the ADF. The text of the proposed rule change is below. Proposed new language is in *italics*; proposed deletions are in [brackets].

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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(f)(6).

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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 nine-month 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 [July 26, 2005] April 26, 2006.

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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

###### 1. 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. NASD subsequently filed for

immediate effectiveness proposed rule changes SR-NASD-2003-067 to extend the pilot until January 26, 2004;<sup>5</sup> SR-NASD-2004-012 to extend the pilot until October 26, 2004;<sup>6</sup> and SR-NASD-2004-160 to extend the pilot until July 26, 2005.<sup>7</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>8</sup> and in conjunction with Nasdaq's anticipated registration as a national securities exchange.<sup>9</sup> In addition, since the Commission gave its initial approval to the ADF pilot, NASD has filed several other ADF-related rule change proposals that have been incorporated into the operation and administration of the pilot.<sup>10</sup>

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

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

<sup>6</sup> Securities Exchange Act Release No. 49131 (January 27, 2004), 69 FR 5229 (February 3, 2004).

<sup>7</sup> Securities Exchange Act Release No. 50601 (October 28, 2004), 69 FR 64611 (November 5, 2004).

<sup>8</sup> Securities Exchange Act Release No. 43863 (January 19, 2001), 66 FR 8020 (January 26, 2001).

<sup>9</sup> Securities Exchange Act Release No. 44396 (June 7, 2001), 66 FR 31952 (June 13, 2001).

<sup>10</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 ADF pilot rules to give jurisdiction to a three-member subcommittee of NASD's Market Regulation Committee to review system outage determinations under NASD Rule 4300A(f) and excused withdrawal denials under NASD 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 NASD Rule 4613A(c) to clarify that NASD may suspend quotations in the ADF displayed by any

The ADF ultimately should 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. In the SuperMontage approval order, the Commission stated that the ADF met the conditions set forth in that order to provide an alternative quotation collection, trade comparison, and trade reporting facility.

NASD believes that 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 for the shorter of nine months or until approval or until approval of the ADF on a permanent basis.

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market participant, including an ECN, that are no longer reasonably related to the prevailing market.

Additionally, NASD filed with the Commission three other rule change proposals. On March 12, 2004, the Commission approved SR-NASD-2003-175, a proposal to repeal NASD 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. On August 18, 2004, the Commission approved SR-NASD-2004-002, 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. On March 10, 2005, the Commission approved SR-NASD-2004-159, a proposed rule change to establish NASD Rule 4400A, which gives NASD authority to receive and review complaints against ADF Market Participants that allege denial of direct or indirect access pursuant to NASD Rule 4300A. Telephone conversation between Philip Shaikun, Associate General Counsel, NASD, and Leah Mesfin, Special Counsel, Division of Market Regulation, Commission, on July 23, 2005.

The proposed rule change will become effective upon filing, will be implemented on July 26, 2005, and will expire on April 26, 2006.

2. Statutory Basis

NASD believes that the rule proposal is consistent with Section 15A(b)(6) of the Act,<sup>11</sup> which requires that NASD rules must be designed to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; to foster cooperation and coordination among persons engaged in regulating, clearing, settling, processing information and facilitating transactions in securities; to 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) of the Act 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 would impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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.

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<sup>11</sup> 15 U.S.C. 78q-3(b)(6).

### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

NASD asserts that the foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>12</sup> and Rule 19b-4(f)(6) thereunder<sup>13</sup> because the rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; or (iii) become operative for 30 days from the day on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest.<sup>14</sup> 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. The Commission finds good cause for the proposed rule change to become operative prior to the 30<sup>th</sup> day after the date of publication of the notice of filing thereof and designates it to be operative immediately because the proposed rule change will prevent the benefits provided by the current ADF pilot program from lapsing.<sup>15</sup>

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate the rule change 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.

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<sup>12</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>13</sup> 17 CFR 240.19b-4(f)(6).

<sup>14</sup> In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to submit to the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Commission has waived that requirement in this case.

<sup>15</sup> For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

#### 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. Comments may be submitted by any of the following methods:

##### Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2005-092 on the subject line.

##### Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-NASD-2005-092. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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 also will be available for inspection and copying at the principal office of NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make

available publicly. All submissions should refer to File Number SR-NASD-2005-092 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>12</sup> 17 CFR 200.30-3(a)(12).