

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-55088; File No. SR-NASD-2007-001)

January 11, 2007

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Amendments to the Alternative Display Facility Rules

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 January 5, 2007, the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been substantially prepared by NASD. NASD has filed the proposal pursuant to Section 19(b)(3)(A) of the Act³ and Rule 19b-4(f)(6) thereunder,⁴ 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 proposes to amend NASD Rules 4130A, 4300A, 4613A, 4617A, and 4632A regarding the Alternative Display Facility (“ADF”) to expand the prohibition on locking or crossing quotations in NMS stocks to include pre-opening and post-closing quotations, extend the obligation to comply with the ADF rules to pre-opening quotes, and replace the specific modifiers identified in Rule 4632A(a)(4) with a more general reference to modifiers as specified

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(6).

by NASD. Below is the text of the proposed rule change. Proposed new language is underlined and proposed deletions are in [brackets].

4000A. NASD ALTERNATIVE DISPLAY FACILITY

4100A. General

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4130A. Prohibition from Locking or Crossing Quotations in NMS Stocks

(a) Definitions. For purposes of these Rules, the following definitions shall apply:

(1) The terms “automated quotation,” “National Market System Plan” (NMS Plan), “intermarket sweep order,” “manual quotation,” “NMS stock,” “protected quotation,” [“regular trading hours,”] and “trading center” shall have the meanings set forth in Rule 600(b) of Regulation NMS under the Securities Exchange Act of 1934.

(2) The term crossing quotation shall mean the display of a bid for an NMS stock [during regular trading hours] at any time between 8:00 a.m. and 6:30 p.m. Eastern Time at a price that is higher than the price of an offer for such NMS stock previously disseminated pursuant to an effective NMS Plan, or the display of an offer for an NMS stock [during regular trading hours] at any time between 8:00 a.m. and 6:30 p.m. Eastern Time at a price that is lower than the price of a bid for such NMS stock previously disseminated pursuant to an effective NMS Plan.

(3) The term locking quotation shall mean the display of a bid for an NMS stock [during regular trading hours] at any time between 8:00 a.m. and 6:30 p.m. Eastern Time at a price that equals the price of an offer for such NMS stock previously disseminated pursuant to an effective NMS Plan, or the display of an offer for an NMS stock [during regular trading hours] at any time between 8:00 a.m. and 6:30 p.m. Eastern Time at a price that equals the price of a bid for such NMS stock previously disseminated pursuant to an effective NMS Plan.

(b) through (d) No Change.

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4300A. Quote and Order Access Requirements

(a) No Change.

(b) Subject to the terms and conditions contained herein, all ADF Trading Centers that display quotations in NASD's ADF must record each item of information described in paragraphs (b)(1) and (2) of this Rule for all orders they receive from another broker-dealer via direct or indirect electronic access, and report this information to NASD as specified below.

(1) ADF Trading Centers must record the following information for every order they receive from another broker-dealer via direct or indirect electronic access[during the trading day]:

(A) through (N) No Change.

The information described in paragraphs (A) through (N) must be reported to NASD within 10 seconds of receipt of the order.

(2) through (7) No Change.

(c) through (g) No Change.

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4600A. TRADING IN NASDAQ SECURITIES

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4613A. Character of Quotations

(a) through (d) No Change.

[(e) Obligations Regarding Locked/Crossed Quotation Conditions in the ADF Prior to Opening]

[(1) Locked/Crossed ADF Quotations Prior to 9:20 a.m.—For locks/crosses that occur in the ADF prior to 9:20 a.m. Eastern Time, a ADF Trading Center that is a party to a lock/cross because the ADF Trading Center either has entered a bid (ask) quotation that locks/crosses another ADF Trading Center’s quotation(s) or has had its quotation(s) locked/crossed by another ADF Trading Center (“party to a lock/cross”) may, beginning at 9:20 a.m. Eastern Time, send an order, making use of direct electronic access in accordance with Rule 4300, of any size, that is at the receiving ADF Trading Center’s quoted price (“Trade-or-Move Message”). Any ADF Trading Center that receives a Trade-or-Move Message at or after 9:20 a.m. Eastern Time, and that is a party to a lock/cross, must within 10 seconds of receiving such message either: fill the incoming order for the full size of the message; or move its bid down (offer up) by a quotation increment that unlocks/uncrosses the ADF.]

[(2) Locked/Crossed ADF Quotations Between 9:20 and 9:29:59 a.m.]

[(A) Before a Registered Reporting ADF ECN enters a quote that would lock or cross the ADF between 9:20 and 9:29:29 a.m. Eastern Time, the ECN must first send, making use of direct electronic access in accordance with Rule 4300, to the market maker or ECN whose quote it would lock or cross a Trade-or-Move Message that is at or superior to the receiving market maker’s or ECN’s quoted price. An ECN that sends a Trade-or-Move Message during these periods must then wait at least 10 seconds before entering a quote that would lock or cross the ADF.]

[(B) If a Registered Reporting ADF Market Maker locks or crosses the ADF between 9:20 and 9:29:29 a.m. Eastern Time, the Registered Reporting ADF Market Maker must then immediately send, making use of direct electronic access in accordance

with Rule 4300, to the market maker whose quotes it is locking or crossing a Trade-or-Move message that is at the receiving market maker's or ECNs quoted price.]

[(C) An ADF Trading Center shall be prohibited from entering a quote that would lock or cross the ADF between 9:29:30 and 9:29:59 a.m.]

[(3) (A) In the case of securities included in the Nasdaq 100 Index or the S&P 400 Index, a Trade-or-Move Message must be for at least 10,000 shares (in instances where there are multiple market makers to a lock/cross, the locking/crossing ADF Trading Center must send a message to each party to the lock/cross and the aggregate size of all such messages must be at least 10,000 shares); provided, however, that if an ADF Trading Center is representing an agency order, the ADF Trading Center shall be required to send a Trade-or-Move Message(s) in an amount equal to the agency order, even if that order is less than 10,000 shares.]

[(B) In the case of all other securities, a Trade-or-Move Message must be for at least 5,000 shares (if multiple market makers would be locked/crossed, each one must receive a Trade-or-Move Message and the aggregate size of all such messages must be at least 5,000 shares); provided, however, that if an ADF Trading Center is representing an agency order, the ADF Trading Center shall be required to send a Trade-or-Move Message(s) in an amount equal to the agency order, even if that order is less than 5,000 shares.]

[(4) An ADF Trading Center that receives a Trade-or-Move Message must, within 10 seconds of receiving such message, either fill the incoming Trade-or-Move Message for the full size of the message, or move its bid down (offer up) by a quotation increment that restores or maintains an unlocked/uncrossed ADF.]

[(5) An ADF Trading Center that sends a Trade-or-Move Message pursuant to this rule must append to the message a symbol indicating that it is a Trade-or-Move Message.]

[(6) For the purposes of this rule “agency order” shall mean an order(s) that is for the benefit of the account of a natural person executing securities transactions with or through or receiving investment banking services from a broker/dealer, or for the benefit of an “institutional account” as defined in Rule 3110. An agency order shall not include an order(s) that is for the benefit of an ADF Trading Center in the security at issue, but shall include an order(s) that is for the benefit of a broker/dealer that is not an ADF Trading Center in the security at issue.]

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4617A. Normal Business Hours

An ADF Trading Center shall be open for business as of 9:30 a.m. Eastern Time and shall close no earlier than 4:00 p.m. Eastern Time. An ADF Trading Center may [remain] be open for business on a voluntary basis for any period of time between 8:00 a.m. Eastern Time and 9:30 a.m. Eastern Time or between 4:00 p.m. Eastern Time and 6:30 p.m. Eastern Time. An ADF Trading Center whose quotes are open before 9:30 a.m. Eastern Time or after 4:00 p.m. Eastern Time shall be obligated to comply, while its quotes are open, with all NASD Rules that are not by their express terms, or by an official interpretation of NASD, inapplicable to any part of the 8:00 a.m. to 9:30 a.m. Eastern Time or the 4:00 p.m. to 6:30 p.m. Eastern Time periods.

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4632A. Transactions Reported by Members to TRACS

(a) When and How Transactions are Reported to TRACS

(1) through (3) No Change.

(4) Other Modifiers Required to be Reported to TRACS

Reporting Members also shall append the [following] applicable trade report modifiers as specified by NASD to all last sale reports, including reports of “as/of” trades[, if applicable]:

(A) [.SLD,] if the trade is executed during normal market hours and it is reported later than 90 seconds after execution;

(B) [.SNN,] if the trade is a Seller’s Option Trade, [.NN] denot[es]ing the number of days for delivery;

(C) [.C,] if the trade is a Cash Trade;

(D) [.ND,] if the trade is a Next Day Trade;

(E) [.W,] if the trade occurs at a price based on an average weighting or another special pricing formula;

(F) [.1,] if the trade is a Stop Stock Transaction (as defined in Rule 4200A)

([n]Note: the time at which the member and the other party agreed to the Stop Stock Price must be given in lieu of including the time of execution on the trade report and the [.1] designated modifier shall not be appended to a report of a Stop Stock Transaction if the Stop Stock Transaction is executed and reported within 90 seconds of the time the member and the other party agree to the Stop Stock Price);

(G) [.PRP,] if the transaction report[s] reflects a price different from the current market when the execution price is based on a prior reference point in time ([n]Note: the transaction report shall include the prior reference time in lieu of the actual time the trade was executed[. The .PRP] and the designated modifier shall not be appended to a report of a transaction whose price is based on a prior reference point in time if the trade is

executed and reported within 90 seconds from the prior reference point in time[or when the transaction is a single-priced opening, re-opening or closing transaction]);

[(H) .4, if the transaction was based upon a single-priced opening, re-opening, or closing transaction by a trading center;]

[(I) .ST,] (H) to identify pre-opening and after-hours trades (executed between 8:00 a.m. and 9:30 a.m. Eastern Time or between 4:00 p.m. and 6:30 p.m. Eastern Time) reported more than 90 seconds after execution;

[(J) .X,] (I) if the trade would be a trade-through of a protected quotation, but for the trade being qualified for an exception or exemption from SEC Rule 611[.] (In order)Note: to ensure consistency in the usage of SEC Rule 611 related modifiers by registered broker-dealers, this modifier will be used in conformity with the specifications approved by the Operating Committee of the relevant National Market System Plans to identify trades executed pursuant to an exception or exemption from SEC Rule 611[.]);

[(K)] (J) [I]if the trade would be a trade-through of a protected quotation, but for the trade being qualified for an exception or exemption from SEC Rule 611, members must, in addition to the modifier required in paragraph (I) above[.X], append an appropriate unique modifier, specified by NASD, that identifies the specific applicable exception or exemption from SEC Rule 611 that a member is relying upon[.] (In order)Note: to ensure consistency in the usage of SEC Rule 611 related modifiers by registered broker-dealers, these modifiers will be used in conformity with the specification approved by the Operating Committee of the relevant National Market System Plans to identify trades executed pursuant to an exception or exemption from SEC Rule 611[.]); and

[(L)] (K) [A]any other modifier as specified by NASD or the Securities and Exchange Commission.

(5) No Change.

(b) through (j) No Change.

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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

The ADF is a quotation collection, trade comparison, and trade reporting facility developed by NASD in accordance with the Commission's SuperMontage Approval Order⁵ and in conjunction with Nasdaq's registration as a national securities exchange. As of the Regulation NMS Trading Phase Date, the ADF will provide market participants (market makers and Electronic Communication Networks (or ECNs))⁶ with the ability to post quotations in NMS stocks, as defined in Rule 600(b)(47) of Regulation NMS, and the ability to view quotations and report transactions in these securities for consolidation and dissemination of data to vendors and

⁵ See Securities Exchange Act Release No. 43863 (January 19, 2001), 66 FR 8020 (January 26, 2001) (SR-NASD-99-53).

⁶ ECNs are defined in Rule 600(b)(23) of Regulation NMS.

ADF market participants. The facility provides for trade comparison through the Trade Reporting and Comparison Service (“TRACS”) and further provides for real-time data delivery to NASD for regulatory purposes, including enforcement of the firm quote and related rules.

On June 29, 2005, the Commission published its release adopting Regulation NMS.⁷ Regulation NMS established new substantive rules designed to modernize and strengthen the regulatory structure of the U.S. equity markets. As part of the rules, Regulation NMS adopted Rule 610, which, among other things, requires NASD and the exchanges to adopt, maintain, and enforce written rules that prohibit their members from engaging in a pattern or practice of displaying any quotations that lock or cross protected quotations and manual quotations that lock or cross quotations disseminated pursuant to an effective National Market System Plan.

On September 28, 2006, the Commission approved SR-NASD-2006-091, which, among other things, amended NASD rules (primarily, ADF rules) to align them with Regulation NMS and to enhance the clarity of the ADF rules. The purpose of the instant proposed rule change is to further those two goals by amending certain of the ADF rule changes approved in SR-NASD-2006-091 to: (1) expand the prohibition on locking or crossing quotations in NMS stocks to include the time periods of 8:00 a.m. to 9:30 a.m. and 4:00 p.m. to 6:30 p.m.; (2) extend the obligation in Rule 4617A to comply with NASD rules to pre-opening quotes; and (3) replace the specific modifiers identified in Rule 4632A(a)(4) with a more general reference to modifiers as specified by NASD. The purpose behind each of these changes is discussed below.

(A) Locking or Crossing Quotations

As approved by the Commission in SR-NASD-2006-091, Rule 4613A generally prohibits a member from displaying a quotation on the ADF that locks or crosses a protected quotation

⁷ See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005).

during regular trading hours (i.e., between 9:30 a.m. and 4:00 p.m. Eastern Time).⁸ ADF Trading Centers, however, are permitted to post quotations on the ADF on a voluntary basis each trading day from 8:00 a.m. Eastern Time until 6:30 p.m. Eastern Time. The proposed rule change would extend the prohibition on locking and crossing quotations to members who voluntarily post quotes on the ADF between 8:00 a.m. and 9:30 a.m. Eastern Time or between 4:00 p.m. and 6:30 p.m. Eastern Time. In addition, the proposed rule change would delete Rule 4613A(e), which addresses locked and crossed quotation conditions in the ADF prior to opening, because the extension of the locking and crossing prohibition in Rule 4130A to that time period would render Rule 4613A(e) obsolete.

(B) Extension of ADF Rules to Pre-Opening Quotations

Although ADF Trading Centers are required to be open for business between 9:30 a.m. Eastern Time and 4:00 p.m. Eastern Time on business days, as noted above, they are permitted, on a voluntary basis, to post quotations on the ADF between the hours of 8:00 a.m. and 9:30 a.m. Eastern Time or between 4:00 p.m. and 6:30 p.m. Eastern Time. As approved by the Commission in SR-NASD-2006-091, Rule 4617A requires an ADF Trading Center whose quotes are open after 4:00 p.m. Eastern Time to comply, while its quotes are open, with all NASD rules that are not by their express terms, or by an official interpretation of NASD, inapplicable to any part of the 4:00 p.m. to 6:30 p.m. Eastern Time period. The proposed rule change would extend this requirement to ADF Trading Centers whose quotes are open between 8:00 a.m. and 9:30 a.m. Eastern Time. Thus, in general, the ADF rules would apply during the entire timeframe during which an ADF Trading Center is permitted to enter quotations on the ADF: 8:00 a.m. through 6:30 p.m. Eastern Time.

⁸ Rule 610(d) of Regulation NMS requires NASD to establish, maintain, and enforce written rules concerning locking and crossing quotations.

Of particular note, this proposed change would, among other things, extend the order reporting requirements found in Rule 4300A(b)(1) and (2) and the firm quote requirement in Rule 4613A(c) to any quotations posted voluntarily before 9:30 a.m. Eastern Time or after 4:00 p.m. Eastern Time. Among the changes approved by the Commission in SR-NASD-2006-091 were amendments to Rule 4300A(e) requiring that ADF Trading Centers submit automated quotations, as defined in Rule 600(b)(3) of Regulation NMS, to the ADF. Automated quotations are, by their nature, firm; thus, the proposed rule change clarifies that the firm quote rule applies to all quotations submitted to the ADF, including quotations submitted before 9:30 a.m. or after 4:00 p.m. Eastern Time. Further, if a firm voluntarily quotes before 9:30 a.m. Eastern Time or after 4:00 p.m. Eastern Time, the member must submit order reports during that time period as required during the normal trading day.⁹

(C) Replacement of Specific Modifiers with General Language

Finally, the proposed rule change would replace the specific modifiers set forth in Rule 4632A(a)(4) with a more general reference to modifiers specified by NASD. As approved by the Commission in SR-NASD-2006-091, Rule 4632A includes specific trade report modifiers for Reporting Members to use when reporting transactions through TRACS if the trade has certain attributes. For example, if the trade is a Cash Trade, Rule 4632A, in the form currently approved

⁹ A member is generally required to submit order reports when the member displays a quote. If a member chooses not to quote before 9:30 a.m. or after 4:00 p.m., the member is not required to submit order reports during those time periods. If a member displays a quote on the ADF at any time during regular trading hours (*i.e.*, 9:30 a.m. to 4:00 p.m. Eastern Time), the member must submit order reports continuously to NASD from the time an initial quote is displayed on the ADF in a security, irrespective of whether the member has a quote displayed on the ADF at the specific time that an order is received. If a member does not display a quote on the ADF in a specific security for the entire time period of 9:30 a.m. to 4:00 p.m. Eastern Time on a given trading day, the member would not be required to submit order reports on the subsequent trade date after the full day of non-quoting on the ADF unless the member displays a quote in that security on the ADF.

by the Commission, would require the Reporting Member to include a “.C” modifier when reporting the trade to TRACS. The proposed rule change would amend Rule 4632A(a)(4) and delete the references to specific modifiers. Instead, the rule would require Reporting Members to append “applicable trade report modifiers as specified by NASD.”¹⁰ Additionally, the proposed rule change deletes the trade report modifier for transactions based upon a single-priced opening, re-opening, or closing transaction because this is an exchange function. NASD will provide members with at least 30 days notice of any new modifiers or any change in existing modifiers.

NASD has filed the proposed rule change for immediate effectiveness. NASD proposes that the proposed rule change be implemented on the Regulation NMS Trading Phase Date. Currently, that date is projected to be February 5, 2007.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹¹ which requires, among other things, that NASD rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles

¹⁰ Rule 4632A(a)(4), as amended by SR-NASD-2006-091, also requires members reporting transactions to the ADF to append “[a]ny other modifier as specified by NASD or the Securities and Exchange Commission.” Pursuant to this provision, NASD believes it has the authority to prescribe additional modifiers be reported solely to NASD. For example, such authority has been used in the context of an update to ADF specifications to require additional modifiers to designate trades that qualify under two existing exemptions from Rule 611 of Regulation NMS (qualified contingent trades and certain sub-penny trade-throughs). This authority may also be used to capture additional regulatory information that NASD deems necessary (e.g., NASD will require more specific delineation of the Intermarket Sweep Order (“ISO”) exception than is required by the National Market System Plan specifications). The National Market System specifications identify both types of ISOs with a single modifier. NASD, however, intends to distinguish between the ISO exceptions by requiring firms to use a separate modifier, as defined by NASD, in instances where the executing firm is responsible for sweeping the market. NASD will provide members with at least 30 days advance written notice and sufficient time to make the necessary systems changes relating to any additional new modifiers.

¹¹ 15 U.S.C. 78o-3(b)(6).

of trade, and, in general, to protect investors and the public interest. NASD believes the proposed rule change facilitates the goals articulated in Regulation NMS, including providing an effective mechanism and regulatory framework for the over-the-counter 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.

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

The foregoing proposed rule change is subject to Section 19(b)(3)(A)(iii) of the Act¹² and Rule 19b-4(f)(6) thereunder¹³ because the proposal: (i) does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) does not become operative prior to 30 days after the date of filing or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest; provided that NASD has given the Commission 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.¹⁴

At any time within 60 days of the filing of such proposed rule change the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary

¹² 15 U.S.C. 78s(b)(3)(A)(iii).

¹³ 17 CFR 240.19b-4(f)(6).

¹⁴ NASD has satisfied the five-day pre-filing requirement.

or appropriate in the public interest, for the protection of investors or otherwise in furtherance of the purposes of the Act.

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. Please include File Number SR-NASD-2007-001 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2007-001. 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 the 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-2007-001 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.¹⁵

Florence E. Harmon
Deputy Secretary

¹⁵ 17 CFR 200.30-3(a)(12).