

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-51092; File No. SR-NASD-2004-159)

January 28, 2005

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change to Allow NASD to Review on a Pilot Basis Denial of Access Complaints Related to the Alternative Display Facility

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 October 22, 2004, 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. On January 11, 2005, NASD filed Amendment No. 1 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

NASD is proposing to establish on a pilot basis new NASD Rule 4400A, which would give NASD the authority to receive and review complaints against an NASD Market

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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> In Amendment No. 1, the Exchange clarified the scope of authority granted to the NASD and the Market Regulation Committee to review denials of access. Amendment No. 1 replaced the original filing in its entirety.

Participant<sup>4</sup> alleging denial of direct or indirect access of the NASD Market Participant's quotations in the Alternative Display Facility ("ADF") that the NASD Market Participant is required to provide pursuant to NASD Rule 4300A. In addition, proposed NASD Rule 4400A would set forth the procedures and review process for such complaints. Finally, the proposal would delegate authority to NASD's Market Regulation Committee to review denial of access determinations rendered in accordance with Rule 4400A. The text of the proposed rule change is available on NASD's Web site (<http://www.nasd.com>), at the principal offices of NASD, and at the Commission's Public Reference Room.

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. 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

Background

On July 24, 2002, the Commission approved SR-NASD 2002-97, which authorizes NASD to operate the ADF on a pilot basis for nine months.<sup>5</sup> NASD subsequently filed for

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<sup>4</sup> See NASD Rule 4300A(d)(4) defining "NASD Market Participant" as: (a) an NASD Registered Reporting ADF Market Maker (defined in NASD Rule 4200A(10)); (b) an alternative trading system or "ATS"; or (c) an NASD ADF Registered electronic communication network or "ECN."

<sup>5</sup> See Securities Exchange Act Release No. 46249 (July 24, 2002), 67 FR 49822 (July 31, 2002).

immediate effectiveness proposed rule changes to extend the pilot, the most recent until July 26, 2005.<sup>6</sup> 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>7</sup> and in conjunction with Nasdaq's proposal to register as a national securities exchange.<sup>8</sup>

Under the pilot, the ADF provides NASD Market Participants 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 exclusive Securities Information Processor ("SIP") for Nasdaq-listed issues<sup>9</sup> 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 or "TRACS." The facility further provides for real-time data delivery to NASD for regulatory purposes, including enforcement of firm quote and related rules.

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<sup>6</sup> See Securities Exchange Act Release Nos. 47663 (April 10, 2003), 68 FR 19043 (April 17, 2003) (SR-NASD-2003-67); 49131 (January 27, 2004), 69 FR 5229 (February 3, 2004) (SR-NASD-2004-12); 50601 (October 28, 2004), 69 FR 64611 (November 5, 2004) (SR-NASD-2004-160).

<sup>7</sup> Securities Exchange Act Release No. 43863 (January 19, 2001), 66 FR 8020 (January 26, 2001) (SR-NASD-99-53).

<sup>8</sup> Securities Exchange Act Release No. 44396 (June 7, 2001), 66 FR 31952 (June 13, 2001) (File No. 10-131).

<sup>9</sup> Nasdaq initially will be the designated SIP for all transactions and quotations in Nasdaq securities. During the pilot period, the SIP will distribute individual quotations for both ADF and Nasdaq market makers and ECNs.

### Order Access Rule

The ADF does not provide an order routing capability. Instead, pilot NASD Rule 4300A requires an NASD Market Participant to provide direct electronic access to other NASD Market Participants and to provide to all other NASD members direct electronic access or allow for indirect electronic access to its quotations in the ADF. This rule provides the means for NASD Market Participants and other broker-dealers to access ADF quotes and, among other things, to meet the firm quote and locked-and-crossed quotation requirements.

### Authority and Review Procedures

The proposed rule change would give NASD the authority to receive and review complaints against an NASD Market Participant alleging denial of direct or indirect access required by NASD Rule 4300A. According to NASD, the proposed rule change is not intended to include complaints that allege: (1) a denial of direct or indirect access because of non-payment of fees for access to an NASD Market Participant's quotations that are imposed by the NASD Market Participant in accordance with SEC rules and regulations or otherwise; or (2) a specific instance or group of instances over discrete time periods where an NASD Market Participant is alleged not to have not honored its quotation in accordance with applicable SEC and NASD rules with respect to orders received electronically pursuant to NASD Rule 4300A.<sup>10</sup> Under the proposed rule change, the process for proper denial of access complaints would be as follows:

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<sup>10</sup> NASD's Market Regulation Department has established a real-time process to receive, evaluate, and act upon firm quote complaints.

The complainant would be required to file a written complaint with ADF Operations via facsimile, personal delivery, courier, or overnight mail that specifically alleges denial of access to an NASD Market Participant's quotation. The complainant would be required to serve a copy of the complaint by the same means on the opposite party in accordance with NASD Rule 9134(b).

The denial of access complaint would be reviewed by an officer designated by a President of NASD or one its divisions to make a determination on the merits of the complaint. The officer could, at his or her discretion, conduct further investigation before rendering a decision as to whether there had been a denial of access in contravention of NASD Rule 4300A. In the event that the officer determined that there had been a denial of access in contravention of NASD Rule 4300A, he or she would direct the offending party to provide access to ADF quotes and could limit participation in the ADF by such party if it did not comply promptly with the directive to provide access. The directive and any action to limit participation in the ADF would become effective and remain in place during the pendency of any further review or appeal.

The proposed rule change also would provide for a review of this initial determination by a three-member subcommittee consisting of current or former members of NASD's Market Regulation Committee ("MRC").<sup>11</sup> A party seeking such review would

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<sup>11</sup> The Market Regulation Committee is an NASD committee that considers the federal securities laws and the rules and regulations adopted thereunder and various NASD Rules and policies relating to: (1) the quotations of securities, (2) the executions of transactions, (3) the reporting of transactions; and (4) trading practices and rules. See NASD Rule 9120(s).

be required to submit a written appeal to NASD by the close of business on the next business day after receipt of the initial determination and simultaneously to serve a copy of the written appeal to the opposite party. The party seeking review would be accorded 24 hours, or a longer period determined by NASD staff, after submission of the appeal to provide NASD and the opposing party any supporting written information concerning the appeal. The opposing party would then have 24 hours, or a longer period determined by NASD staff, to submit written documentation in support of its position. A three-member subcommittee of current or former MRC members would then render a final determination to affirm or reverse the determination of the NASD officer based on the record and any hearing it shall, in its discretion, determine to hold.

The proposal would require the MRC subcommittee to provide written notification of its decision by the close of business the day following its determination. The decision, including affirmation of any directive to provide access or action to limit participation in the ADF rendered by the NASD officer, would be effective upon issuance of the written decision and remain in effect during the pendency of further appeals or other legal proceedings. The MRC subcommittee could not impose any additional sanctions, including monetary fines; its authority would be limited to affirming or reversing the determination of the NASD officer.

The MRC decision would constitute final NASD action, which could be appealed to the Commission. The decision would not prejudice the rights of the parties to subsequently submit the matter to arbitration or another adjudicatory forum as appropriate. Furthermore, the decision would not operate as an estoppel or otherwise bind NASD in any subsequent disciplinary action or other legal proceeding. Amendment No. 1 to the proposed rule change

clarifies the scope of the authority granted to NASD and its MRC to review alleged denial of access complaints pursuant to NASD Rule 4300A and limits the remedies that may be imposed as part of the review.

#### Plan of Allocation and Delegation to Subsidiaries

Pursuant to Article XIII, Section 1 of the NASD By-Laws, the Board of Governors is vested with the authority to limit the activities, functions, and operations of members for failure to comply with NASD rules. Section 2 of Article XIII permits the Board of Governors to delegate that authority. In accordance with those provisions, the proposed rule change also would amend the Plan of Allocation and Delegation to Subsidiaries to expressly delegate to the MRC the authority to review denial of access determinations in accordance with the NASD Rule 4000A Series.

If the Commission approves the proposal, NASD would announce the effective date of the new rule in a Notice to Members to be published no later than 60 days following Commission approval. The effective date would be 30 days following publication of the Notice to Members announcing Commission approval.

#### 2. Statutory Basis

NASD believes that the proposed rule change, as amended, is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>12</sup> which requires, among other things, that NASD's rules 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.

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<sup>12</sup> 15 U.S.C. 78o-3(b)(6)

NASD believes that the procedures to hear denial of access complaints would maintain the integrity of the ADF and provide a fair process for review.

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

NASD does not believe that the proposed rule change, as amended, would 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

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, as amended, 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 e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2004-159 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549-0609.

All submissions should refer to File Number SR-NASD-2004-159. 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 will also 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-2004-159 and should be submitted on or before [insert date 21 days from the date of publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>13</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>13</sup> 17 CFR 200.30-3(a)(12).