

pursuant to this Rule, or the conditions imposed on their reentry.

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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

*Background.* On July 24, 2002, the Commission approved SR-NASD 2002-97, which authorizes NASD to operate the ADF on a pilot basis in Nasdaq securities for nine months, pending the anticipated approval of SR-NASD-2001-90, which proposes to operate the ADF on a permanent basis.<sup>7</sup> On April 10, 2003, the Commission approved SR-NASD-2003-53, authorizing extension of the ADF pilot period until January 26, 2004.<sup>8</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>9</sup> and in conjunction with Nasdaq's anticipated registration as a national securities exchange.<sup>10</sup>

For the duration of the pilot period, ADF will provide ADF market participants (market makers and ECNs) the ability to post quotations in Nasdaq securities and will provide 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>11</sup> for consolidation and dissemination of data

to vendors and ADF market participants. The facility also will provide for trade comparison through the Trade Reporting and Comparison Service ("TRACS"). The facility further will provide for real-time data delivery to NASD for regulatory purposes, including enforcement of firm quote and related rules. It is anticipated that the ADF will operate on a pilot basis until the effective date of SR-NASD-2001-90, the approval of which would provide for the operation of the ADF on a permanent basis and an expansion of ADF-eligible securities to include all exchange-listed securities.

*Order Access Rule.* The ADF does not provide an order routing capability. Instead, NASD pilot Rule 4300A requires market participants to provide direct electronic access to other market participants and to provide to all other NASD members direct electronic access or allow for indirect electronic access to the individual market participant's quote. This rule provides the means for ADF 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.

*System Outage Determinations.* Pursuant to NASD Rule 4300A(e)(2), NASD may suspend a market participant from quoting for 20 business days if the market participant experiences three unexcused, confirmed system outages during any period of five business days. The Rule defines system outages as (1) an inability to quote or (2) an inability to respond to orders. The Rule gives officers of NASD authority to review an outage and determine whether the outage should be excused. An officer may deem a system outage excused based on the specific facts and circumstances surrounding the outage. Most significant consideration is given to whether the system outage resulted from circumstances beyond the market participant's control and whether the market participant voluntarily brought the matter to the attention of NASD before it otherwise learned of the outage. Other factors that may be considered include, but are not limited to, the extent and duration of the system problem.

Rule 4300A provides for a review and appeal process of a determination of whether an outage is excused or unexcused. Currently, Rule 4300A(f)(5) gives authority for such reviews to NASD's Alternative Display Facility Market Operations Review Committee. The proposed rule change would amend that provision to give review authority to a three-member subcommittee comprised of current or former industry

members of NASD's MRC to take advantage of that committee's expertise. It would be NASD's intention to draw first from current MRC members and resort to former members only when conflicts or availability problems exist with current members.

*Denial of Excused Withdrawals.* NASD Rule 4619A generally provides that NASD Alternative Display Facility Operations may, under certain circumstances, grant excused withdrawal status to an ADF Market Maker that withdraws its quotations from a security. Rule 4619A(g) provides for review of a denial of an excused withdrawal and gives authority for such reviews to NASD's Alternative Display Facility Market Operations Review Committee. The proposed rule change would amend that provision to give review authority to a three-member subcommittee comprised of current or former industry members of the MRC, as would be the case for system outage proceedings described above.

#### 2. Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>12</sup> which requires, among other things, that NASD 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. NASD believes that the MRC is the appropriate committee to review ADF system outage and excused withdrawal determinations.

### 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

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

<sup>7</sup> Securities Exchange Act Release No. 46249 (July 24, 2002), 67 FR 49822 (July 31, 2002).

<sup>8</sup> Securities Exchange Act Release No. 47633 (April 10, 2003), 68 FR 19043 (April 17, 2003).

<sup>9</sup> Securities Exchange Act Release No. 43863 (January 19, 2001), 66 FR 8020 (January 26, 2001).

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

<sup>11</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.

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