

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50405; File No. SR-NASD-2004-071]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Change and Amendment Nos. 1 and 2 Thereto Relating to Improved Nasdaq Opening Process

September 16, 2004.

I. Introduction

On April 23, 2004, the National Association of Securities Dealers, Inc. ("NASD"), through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change to improve the opening process for Nasdaq securities. On May 27, 2004, Nasdaq amended the proposed rule change.³

The proposed rule change, as amended by Amendment No. 1, was published for comment in the **Federal Register** on June 17, 2004.⁴ The Commission received two comment letters on the proposal, as amended.⁵ Nasdaq submitted a response to the comment letters.⁶ On September 15, 2004, Nasdaq amended the proposed rule change.⁷ This order approves the proposed rule change, as amended.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Mary M. Dunbar, Vice President and Deputy General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division of Market Regulation ("Division"), Commission, dated May 26, 2004 ("Amendment No. 1"). In Amendment No. 1, Nasdaq restated the proposed rule change in its entirety.

⁴ See Securities Exchange Act Release No. 49842 (June 9, 2004), 69 FR 33971.

⁵ See letter from James P. Selway III, Managing Director, White Cap Trading LLC, to Jonathan G. Katz, Secretary, Commission, dated July 7, 2004 ("White Cap Letter"); and letter from Kim Bang, President and Chief Executive Officer, Bloomberg Tradebook LLC, to Jonathan G. Katz, Secretary, Commission, dated July 13, 2004 ("Bloomberg Letter").

⁶ See letter from Jeffrey Davis, Associate General Counsel, Nasdaq, to Katherine England, Division of Market Regulation, Commission, dated July 21, 2004 ("Nasdaq Response Letter").

⁷ See letter from Mary M. Dunbar, Vice President and Deputy General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division, Commission, dated September 15, 2004 ("Amendment No. 2"). In Amendment No. 2, Nasdaq revised the language of Rule 4706(a)(1)(B)(xiii) to reflect changes made by File No. SR-NASD-2004-076. See Securities Exchange Act Release No. 50074 (July 23, 2004), 69 FR 45866 (July 30, 2004). This was a technical amendment and is not subject to notice and comment.

II. Description of Proposed Rule Change

The proposed rule change is intended by Nasdaq to improve the pre-open trading environment for Nasdaq-listed securities, and to create two new voluntary opening processes that would together constitute the beginning of the trading day for all Nasdaq-listed securities. The changes to the pre-open environment would eliminate the Trade-or-Move process contained in NASD Rule 4613(e), create pre-opening eligible order types, and open all market participant quotes at 9:25 a.m. rather than 9:29:30 a.m.

The new 9:30 a.m. opening process would take one of two forms: The Nasdaq Opening Cross or the Modified Nasdaq Opening. Certain Nasdaq-listed stocks would be designated to participate in the Nasdaq Opening Cross, which Nasdaq has designed to complement the recently implemented Nasdaq Closing Cross. There would be three components of the Nasdaq Opening Cross: (1) The creation of On Open and Imbalance Only order types; (2) the dissemination of an order imbalance indicator via a Nasdaq proprietary data feed; and (3) opening cross processing in the Nasdaq Market Center at 9:30 a.m. that would execute the maximum number of shares at a single, representative price that would be the Nasdaq Official Opening Price. Upon initial implementation, Nasdaq plans to apply the Nasdaq Opening Cross to securities included in the Nasdaq 100 Index, the S&P 500 Index, and the Nasdaq Biotech Index, although Nasdaq would have the authority to apply the Nasdaq Opening Cross to any and all Nasdaq securities. Nasdaq designed the proposal to create a more robust opening that allows for price discovery, and executions that result in an accurate, tradable opening price.

For those Nasdaq securities that do not participate in the Nasdaq Opening Cross, the Modified Nasdaq Opening would integrate quotes and orders entered during pre-market hours with orders designated for execution during the normal trading day (9:30 a.m. to 4 p.m.), create an unlocked inside bid and offer in the Nasdaq Market Center, and facilitate an orderly process for opening trading at 9:30 a.m. These securities would continue to have their Nasdaq Official Opening Price calculated as today.

III. Comment Summary

The White Cap Letter supported Nasdaq's proposed rule change. In particular, the White Cap Letter stated that the Nasdaq Opening Cross would remedy a long-standing problem with

Nasdaq's market structure: *i.e.*, the lack of a formalized and transparent opening process. White Cap stated that, based on its experience with the Nasdaq Closing Cross over the preceding three months, it believed that the Nasdaq Opening Cross would afford market participants the opportunity to enter on-open orders for execution at a single price, to view indicated prices and volumes as well as any imbalances, and to interact with such indications on a competitive basis. White Cap acknowledged the fact that order-delivery electronic communication networks ("ECNs") would not participate in the Nasdaq Opening Cross as a consequence of technological concerns and competitive realities. White Cap believed that, because the Nasdaq Opening Cross would be directly accessible to all interested and qualified parties, its benefits should redound to the marketplace regardless of the fact that certain quotes do not participate.

The Bloomberg Letter objected to the requirement that trading interest be subject to automatic execution in order to take part in the Nasdaq Opening Cross, which it said would effectively eliminate participating ECNs from the process. The Bloomberg Letter opined that, because the Nasdaq Opening Cross would exclude trades, and therefore liquidity, in Nasdaq securities that occur on ECNs that have elected order delivery rather than automatic execution, the opening price likely would be inaccurate, incomplete and misleading, harm participating ECNs and their investor participants, and make it more difficult for broker-dealers participating in SuperMontage to meet their best execution obligations. Bloomberg stated that Nasdaq had offered no legitimate basis for excluding ECNs from the Nasdaq Opening Cross. The Bloomberg Letter also argued that the amendments to the pre-opening process would effectively mean that the Nasdaq market would open at 9:25 a.m., and that Nasdaq had not explained this in the proposed rule change. The Bloomberg Letter opined that mixing firm quotes of ECNs with the indicative quotations of market makers in an undifferentiated data stream would not be in the public interest. The Bloomberg Letter stated that Nasdaq has "buried secret rules in its technical specification," that should have been the subject of public disclosure and public comment. Finally, the Bloomberg Letter commented that the proposed rule change would violate Section 15A(b)(6) of the Act,⁸ which requires that the rules of a national securities

⁸ 15 U.S.C. 78o-3(b)(6).

association not be designed to permit unfair discrimination between customers, issuers, brokers or dealers, and would constitute a constructive denial of access to ECNs, which would constitute, in turn, an unnecessary or inappropriate burden on competition in violation of Section 15A(b)(8) of the Act.⁹

In its response letter, Nasdaq acknowledged the White Cap Letter and spoke to the comments raised in the Bloomberg Letter. Nasdaq stated that Bloomberg's business decision to execute orders internally within Bloomberg's book rather than offering automatic execution on SuperMontage should not impede Nasdaq from proceeding with a market enhancement. Nasdaq suggested that there are multiple options that Bloomberg could pursue to satisfy its customers' interest in participating fully in the Nasdaq Opening Cross, such as (1) by participating in the Opening Cross on an automatic execution basis; (2) by routing standing limit orders through another participant that participates on an automatic execution basis, or (3) by discussing with Nasdaq the possibility of establishing a second market participant identifier for the entry of orders eligible to participate in the Nasdaq Opening Cross. Moreover, Nasdaq stated that the Opening Cross is inherently a "match"—matching interest of buyers and sellers at a single instant in time—and is not conducive to an iterative order delivery process, which would create substantial technical difficulties for Nasdaq and unwarranted risk for other market participants. Nasdaq pointed out that participation in the Nasdaq Opening Cross is completely voluntary and that Bloomberg is effectively excluding itself from the process.

Nasdaq stated that Bloomberg misunderstood the proposed rule change with respect to the pre-opening process, saying that Nasdaq is modifying the pre-opening process in order to improve and emphasize the official open at 9:30 a.m., and that the 9:25 a.m. opening of quotes would dramatically improve the 9:30 a.m. open, not replace it. Nasdaq also pointed out that, with respect to Nasdaq's "buried secret rules," Nasdaq has a practice of making its technical specifications publicly available far in advance of its proposed launch dates and has a natural interest in having the document widely scrutinized and used by market participants.¹⁰

Nasdaq stated that the Closing Cross has performed as it was designed and, overall has improved the Nasdaq closing process. Thus, Nasdaq believes that the Nasdaq Opening Cross will provide similar benefits to the opening process.

IV. Discussion and Commission's Findings

After careful consideration of the proposed rule change, the comment letters, and Nasdaq's response to the comment letters, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.¹¹ The Commission believes that the proposed rule change is consistent with Section 15A(b) of the Act,¹² in general, and furthers the objectives of Section 15A(b)(6),¹³ in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, 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.

The Commission believes that Nasdaq has adequately addressed the comments raised in the comment letters. The Commission also believes that the proposed rule change, as amended, should provide useful information to market participants and increase transparency and order interaction at the open. In addition, the Commission believes that the proposed rule change, as amended, should result in the public dissemination of information that more accurately reflects the trading in a particular security at the open.

V. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and rules and regulations thereunder applicable to a national securities association, and, in particular, Section 15A(b) of the Act.¹⁴

¹¹ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹² 15 U.S.C. 78o-3(b).

¹³ 15 U.S.C. 78o-3(b)(6).

¹⁴ 15 U.S.C. 78o-3(b).

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹⁵ that the proposed rule change (SR-NASD-2004-071), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁶

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. E4-2349 Filed 9-22-04; 8:45 am]

BILLING CODE 8010-01-P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50403; File No. SR-NASD-2004-110]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Divestiture of American Stock Exchange

September 16, 2004.

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 July 16, 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 August 10, 2004, NASD amended the proposal.³ NASD further amended the proposal on August 25, 2004,⁴ and on September 3, 2004.⁵ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

¹⁵ 15 U.S.C. 78s(b)(2).

¹⁶ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Barbara Z. Sweeney, Senior Vice President and Corporate Secretary, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation ("Division"), Commission, dated August 10, 2004 ("Amendment No. 1"). Amendment No. 1 replaced NASD's original filing in its entirety.

⁴ See letter from Barbara Z. Sweeney, Senior Vice President and Corporate Secretary, NASD, to Katherine A. England, Assistant Director, Division, Commission, dated August 25, 2004 ("Amendment No. 2"). Amendment No. 2 replaced NASD's earlier amended filing in its entirety.

⁵ See letter from Barbara Z. Sweeney, Senior Vice President and Corporate Secretary, NASD, to Katherine A. England, Assistant Director, Division, Commission, dated September 2, 2004 ("Amendment No. 3"). Amendment No. 3 modified Exhibit 1 and made certain technical corrections to the proposal. Amendment No. 3 replaced NASD's earlier amended filing in its entirety.

⁹ 15 U.S.C. 78o-3(b)(8).

¹⁰ Nasdaq published the technical specifications on June 17, 2004.