SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-49715; File No. SR-NASD-2004-061)

May 17, 2004

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change and Amendment No. 1 Thereto by the National Association of Securities Dealers, Inc. Relating to the Listing and Trading of 97% Protected Notes Linked to the Global Equity Basket

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 April 5, 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" or "SEC") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq. Nasdaq filed Amendment No. 1 to the proposed rule change on May 12, 2004.[3] The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons and is approving the proposal on an accelerated basis.

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

Nasdaq proposes to list and trade 97% Protected Notes Linked to the Performance of the Global Equity Basket ("Notes") issued by Merrill Lynch & Co., Inc. ("Merrill Lynch").

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See letter from Alex Kogan, Associate General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division of Market Regulation ("Division"), Commission, dated May 10, 2004 ("Amendment No. 1"). In Amendment No. 1, Nasdaq provided certain details about the Nikkei 225 Index and the ES 50 Index.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, Nasdaq 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 III below. Nasdaq 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

Nasdaq proposes to list and trade the Notes. The Notes provide for a return based upon the Global Equity Basket ("Basket") and for protection of 97% of the principal. The Basket is a basket of three indexes, each initially equally weighted: the Nikkei 225 Index ("Nikkei"), the Dow Jones EURO STOXX 50 Index ("ES50"), and the S&P 500 Index ("S&P 500").

Under Rule 4420(f), Nasdaq may approve for listing and trading innovative securities that cannot be readily categorized under traditional listing guidelines.[4] Nasdaq proposes to list the Notes for trading under NASD Rule 4420(f).

The Notes, which will be registered under Section 12 of the Act, will initially be subject to Nasdaq's listing criteria for other securities under NASD Rule 4420(f). Specifically, under NASD Rule 4420(f)(1):

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[4] See Securities Exchange Act Release No. 32988 (September 29, 1993); 58 FR 52124 (October 6, 1993) ("1993 Order").

(A) The issuer shall have assets in excess of $100 million and stockholders' equity of at least $10 million.[5] In the case of an issuer which is unable to satisfy the income criteria set forth in paragraph (a)(1), Nasdaq generally will require the issuer to have the following: (i) assets in excess of $200 million and stockholders' equity of at least $10 million; or (ii) assets in excess of $100 million and stockholders' equity of at least $20 million;

(B) There must be a minimum of 400 holders of the security, provided, however, that if the instrument is traded in $1,000 denominations, there must be a minimum of 100 holders;

(C) For equity securities designated pursuant to this paragraph, there must be a minimum public distribution of 1,000,000 trading units; and

(D) The aggregate market value/principal amount of the security will be at least $4 million.

In addition, Merrill Lynch satisfies the listed marketplace requirement set forth in NASD Rule 4420(f)(2).[6] Lastly, pursuant to NASD Rule 4420(f)(3), prior to the commencement of trading of the Notes, Nasdaq will distribute a circular to members providing guidance regarding compliance responsibilities and requirements, including suitability recommendations, and highlighting the special risks and characteristics of the Notes. In particular, Nasdaq will advise members recommending a transaction in the Notes to have reasonable grounds for believing that the recommendation is suitable for

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5 Merrill Lynch satisfies this listing criterion.

6 NASD Rule 4420(f)(2) requires issuers of securities designated pursuant to this paragraph [sic] to be listed on Nasdaq or the New York Stock Exchange ("NYSE") or be an affiliate of a company listed on Nasdaq or the NYSE; provided, however, that the provisions of NASD Rule 4450 will be applied to sovereign issuers of "other" securities on a case-by-case basis.

their customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs. In addition, pursuant to NASD Rule 2310(b), prior to the execution of a transaction in the Notes that has been recommended to a non-institutional customer, a member shall make reasonable efforts to obtain information concerning: (1) the customer's financial status; (2) the customer's tax status; (3) the customer's investment objectives; and (4) such other information used or considered to be reasonable by such member in making recommendations to the customer.

The Notes will be subject to Nasdaq's continued listing criterion for other securities pursuant to Rule 4450(c). Under this criterion, the aggregate market value or principal amount of publicly held units must be at least $1 million. The Notes also must have at least two registered and active market makers as required by Rule 4310(c)(1). Nasdaq will also consider prohibiting the continued listing of the Notes if Merrill Lynch is not able to meet its obligations on the Notes.

The Notes are a series of senior non-convertible debt securities that will be issued by Merrill Lynch and will not be secured by collateral. The Notes will rank equally with all of Merrill Lynch's other unsecured and unsubordinated debt. The Notes will be issued in denominations of whole units ("Unit"), with each Unit representing a single Note. The original public offering price will be $10 per Unit. The Notes will have a term to maturity of 93 months. The Notes will not pay interest and are not subject to redemption either by Merrill Lynch or at the option of any beneficial owner before maturity.[7]

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[7] The actual maturity date is February 14, 2012.

At maturity, a beneficial owner will be entitled to receive a payment on the Notes based on the value of the Basket, but not less than $9.70 per Unit ("Minimum Redemption Amount"). Thus, the Notes provide investors the opportunity to obtain returns based on the Basket, and they provide for the return of at least 97% of the principal amount per Unit.

Any payment that a beneficial owner may be entitled to receive in addition to the Minimum Redemption Amount (the "Supplemental Redemption Amount") will depend entirely on: (a) the change in the average value of the Basket at the close of the market on five business days shortly before the maturity of the Notes (the "Ending Value") from the Basket's value when the Notes are priced for initial sale to the public, which will be set at 100 (the "Starting Value"), and (b) the Participation Rate, which will be a fixed value between 1.00 and 1.05, as determined by Merrill Lynch on the date the Notes are priced for initial sale to the public and disclosed in the final prospectus supplement to be delivered in connection with sales of the Notes.[8]

On the date when the Notes are priced, a multiplier will be assigned to each component index in the Basket, such that the product of such a multiplier and of the price of such an index is equal to 33.333. The value of the Basket will be the sum of the prices of its three component indexes, where each such price is adjusted by the use of a

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[8] Merrill Lynch has advised Nasdaq that Merrill Lynch will determine the exact value of the Participation Rate based, in part, on the prevailing level of interest rates and other financial market conditions on the date when the Notes are initially priced. Such value will be within the range listed above. The value of the Participation Rate will determine the minimum Ending Value needed in order for a beneficial owner to be entitled at maturity to receive at least the full principal amount per Unit. However, under no circumstances, will the beneficial owner be entitled at maturity to less than 97% of the principal amount per Unit.

multiplier; the specific multiplier for each index is determined on the pricing date so as to assure that, initially, each index is weighted equally in the Basket (hence, the Starting Value will be equal to (33.333 x 3) or 100). The same multipliers that are determined on the date of Note pricing will then be used prior to maturity to calculate the Ending Value. Each component index's value will be adjusted by its initially established multiplier, and the sum of such three products will constitute the Ending Value. As such, the Ending Value will reflect the change that may have occurred in the combined value of the three component indexes, where the change in the value of each index is given equal weight.

The Supplemental Redemption Amount per Unit will equal:

$$\left(\$10 \times \left(\frac{\text{Ending Value - Starting Value}}{\text{Starting Value}}\right) \times \text{Participation Rate}\right),$$

but will not be less than zero.

As a result, the Basket value will need to increase by a percentage between 2.87% and 3.00%, depending upon the actual Participation Rate (and assuming that it is, as expected, in the range of 1.00 to 1.05[9]), in order for a beneficial owner to be entitled to receive a total amount at maturity equal to the principal amount. If the value of the Basket decreases or does not increase sufficiently, a beneficial owner will be entitled to less than the principal amount of $10 per Unit. In no event, however, will a beneficial owner be entitled to less than the Minimum Redemption Amount.

The Notes are cash-settled in U.S. dollars and do not give the holder any right to receive a portfolio security, dividend payments or any other ownership right or interest in the portfolio or index of securities comprising the Basket. The Notes are designed for

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[9] See Amendment No. 1, supra note 3.

investors who want to participate or gain exposure to the Basket, while protecting 97% of the principal, and who are willing to forego market interest payments on the Notes during the term of the Notes. The Commission has previously approved the listing of securities the performance of which has been directly or indirectly linked to or based on (wholly or partially) the Nikkei,[10] the ES50,[11] and the S&P.[12]

As stated, the Notes provide for a return on the Basket, which is a basket of three indexes, each initially equally weighted: the Nikkei 225 Index ("Nikkei"), the Dow Jones EURO STOXX 50 Index ("ES50"), and the S&P 500 Index ("S&P 500").

The Nikkei is a stock index calculated, published and disseminated by Nihon Keizai Shimbun, Inc. ("NKS"), which measures the composite price performance of selected Japanese stocks. The Notes are not sponsored, endorsed, sold or promoted by NKS. NKS is a recognized source of business information in Japan and publishes a large

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10 See Securities Exchange Act Release No. 38940 (August 15, 1997), 62 FR 44735 (August 22, 1997) (approving the listing and trading of Market Index Target-Term Securities, the return on which is based on changes in the value of a portfolio of 11 foreign indexes, including Nikkei).

11 See Securities Exchange Act Release Nos. 40303 (August 4, 1998), 63 FR 42892 (August 11, 1998) (approving listing of BRoad InDex Guarded Equity-linked Securities linked to the value of the ES50); and 46021 (June 3, 2002), 67 FR 39753 (June 10, 2002) (approving listing of notes based on the Dow Jones EURO STOXX 50 Return Index, which is based on the ES50).

12 See Securities Exchange Act Release Nos. 48677 (October 21, 2003), 68 FR 61524 (October 28, 2003) (approving the listing and trading of Accelerated Return Notes linked to the S&P 500); 47464 (March 7, 2003), 68 FR 12116 (March 13, 2003) (approving the listing and trading of Market Recovery Notes Linked to the S&P 500); 30394 (February 21, 1992), 57 FR 7409 (March 2, 1992) (approving the listing and trading of a unit investment trust linked to the S&P 500); 27382 (October 26, 1989), 54 FR 45834 (October 31, 1989) (approving the listing and trading of Exchange Stock Portfolios based on the value of the S&P 500); 31591 (December 11, 1992), 57 FR 60253 (December 18, 1992) (approving the listing and trading of Portfolio Depositary Receipts based on the S&P 500); and 19907 (June 24, 1983), 48 FR 30814 (July 5, 1983) (approving the listing and trading of options on the S&P 500).

business daily, The Nihon Keizai Shimbun, and four other financial newspapers. NKS is not affiliated with a securities broker or dealer. The Commission has previously approved the listing of other securities the performance of which has been linked to or based on, the Index.[13]

The Nikkei is currently based on 225 underlying common stocks traded on the Tokyo Stock Exchange (the "TSE") and represents a broad cross-section of Japanese industry. All 225 underlying stocks are listed in the First Section of the TSE and are, therefore, among the most actively traded stocks on the TSE. The Nikkei is a modified, price-weighted index, which means a component stock's weight in the Nikkei is based on its price per share rather than total market capitalization of the issuer.

NKS calculates the Nikkei by multiplying the per share price of each underlying stock by the corresponding weighting factor for that underlying stock (a "Weight Factor"), calculating the sum of all these products and dividing that sum by a divisor. The divisor, initially set on May 16, 1949 at 225, was 23.156 as of April 30, 2004, and is subject to periodic adjustments as set forth below. Each Weight Factor is computed by dividing ¥50 by the par value of the relevant underlying stock, so that the share price of each underlying stock when multiplied by its Weight Factor corresponds to a share price based on a uniform par value of ¥50. Each Weight Factor represents the number of

[13] See Securities Exchange Act Release Nos. 49670 (May 7, 2004) (approving the listing and trading of Accelerated Return Notes Linked to the Nikkei 225 Index); 38940 (August 15, 1997), 62 FR 44735 (August 22, 1997) (approving the listing and trading of Market Index Target-Term Securities, the return on which is based on changes in the value of a portfolio of 11 foreign indexes, including the Nikkei 225 Index); and 27565 (December 22, 1989), 55 FR 376 (January 4, 1990) (approving listing of Index Warrants based on the Nikkei Stock Average and noting the existence of a Memorandum of Understanding between the Commission and the Japanese Ministry of Finance for surveillance purposes).

shares of the related underlying stock, which are included in one trading unit of the Nikkei. The stock prices used in the calculation of the Nikkei are those reported by a primary market for the underlying stocks, which is currently the TSE. The level of the Index is calculated once per minute during TSE trading hours. The value of the Index is readily accessible by U.S. investors at the following web sites: http://www.nni.nikkei.co.jp and http://www.bloomberg.com. As noted below, because of the time difference between Tokyo and New York, the closing level of the Index on a trading day will generally be available in the United States by the opening of business on the same calendar day.

In order to maintain continuity in the level of the Nikkei in the event of certain changes due to non-market factors affecting the underlying stocks, such as the addition or deletion of stocks, substitution of stocks, stock dividends, stock splits or distributions of assets to stockholders, the divisor used in calculating the Nikkei is adjusted in a manner designed to prevent any instantaneous change or discontinuity in the level of the Index. The divisor remains at the new value until a further adjustment is necessary as the result of another change. As a result of each change affecting any Underlying Stock, the divisor is adjusted in such a way that the sum of all share prices immediately after the change multiplied by the applicable Weight Factor and divided by the new divisor, i.e., the level of the Index immediately after the change, will equal the level of the Index immediately prior to the change.[14]

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14 Underlying stocks of the Nikkei may be deleted or added by NKS. However, to maintain continuity in the Index, the policy of NKS is generally not to alter the composition of the Underlying Stocks except when an Underlying Stock is deleted in accordance with the following criteria. Any stock becoming ineligible for listing in the First Section of the TSE due to any of the following reasons will

As of April 30, 2004, the average daily trading volume for a single Nikkei component was approximately 4.8 million shares.[15] As of the same date, the market capitalization of the components ranged from 14.4 trillion yen to 33.7 billion yen. These figures correspond approximately to 130 billion U.S. dollars and 305 million U.S. dollars.

The Nikkei is composed of 225 securities and is broad-based. The highest-weighted stock in the Index has the weight of 3.35%; all other components have lower weights. The top five stocks in the Nikkei have the cumulative weight of approximately 14.3%.

The ES50 was created and is published by STOXX, a joint venture founded by SWX-Swiss Exchange, SBF-Bourse de Paris, Deutsche Borse AG and Dow Jones & Company. The companies that are included in the ES50 are selected by STOXX and are representative of a broad market and a wide array of European industries. Publication of the ES50 began on February 26, 1998, based on an initial value of the ES50 of 1,000 at December 31, 1991. The ES50 is currently calculated by (i) multiplying the per share price of each underlying security by the number of outstanding shares (and, if the stock is not quoted in euros, then multiplied by the country currency and an exchange factor

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be deleted from the Underlying Stocks: bankruptcy of the issuer; merger of the issuer into, or acquisition of the issuer by, another company; delisting of the stock or transfer of the stock to the "Seiri-Post" because of excess debt of the issuer or because of any other reason; or transfer of the stock to the Second Section of the TSE. Upon deletion of a stock from the Nikkei, NKS will select, in accordance with certain criteria established by it, a replacement for the deleted underlying stock. In an exceptional case, a newly listed stock in the First Section of the TSE that is recognized by NKS to be representative of a market may be added to the underlying stocks. As a result, an existing underlying stock with low trading volume and not representative of a market will be deleted.

15 This figure represents the average number of shares traded for the past 30 trading days. It is calculated by taking the sum of the volumes of the individual Nikkei components for the past 30 trading days and dividing it by 30.

which reflects the exchange rate between the country currency and the euro); (ii) calculating the sum of all these products (the "Index Aggregate Market Capitalization"); and (iii) dividing the Index Aggregate Market Capitalization by a divisor which represents the Index Aggregate Market Capitalization on the base date of the ES50 and which can be adjusted to allow changes in the issued share capital of individual underlying securities, including the deletion and addition of stocks, the substitution of stocks, stock dividends and stock splits, to be made without distorting the ES50. The value of the ES50 is updated by STOXX every 15 seconds when the European markets are open. The 15-second value of the ES50 and the identity of the individual ES50 components can be accessed from www.stoxx.com.

Moreover, the following stock markets are currently the primary listing markets for the ES50 components: Deutsche Borse (21.3% of the ES50 weight), Euronext Amsterdam (18.2%),[16] Borsa Italiana (10.9%), Euronext Paris (32.2%), the Spanish Stock Market (13.1%) and HEX Helsinki (4%). A number of the ES50 components are traded on more than one major European market. In addition, 34 of the 50 ES50 issuers currently have sponsored ADRs listed on the New York Stock Exchange, and 4 have non-sponsored ADRs trading in the United States.

The composition of the ES50 is reviewed annually, and changes are implemented on the third Friday in September, using market data from the end of July as the basis for the review process. Changes in the composition of the ES50 are made to ensure that the ES50 includes those companies that, within the eligible countries and within each

16 One of the component stocks with a primary listing in Amsterdam maintains a second "primary listing" on Euronext Brussels. This component comprises approximately 1.6% of the total ES50 weight.

industry sector, have the greatest market capitalization. Changes in the composition of the ES50 are made entirely by STOXX without consultation with the corporations represented in the ES50 or with Merrill Lynch. The ES50 is also reviewed on an on-going basis, and change in the composition of the ES50 may be necessary if there have been extraordinary events for one of the issuers of the underlying securities, e.g., delisting, bankruptcy, merger or takeover. In these cases, the event is taken into account as soon as it is effective. The underlying securities may be changed at any time for any reason. Neither STOXX nor any of its founders is affiliated with Merrill Lynch and neither has participated in any way in the creation of the Notes.

Merrill Lynch or its affiliates may presently and from time to time engage in business with the publishers, owners or creators of the ES50 or the issuers of the underlying securities, including extending loans to, making equity investments in or providing advisory services, including merger and acquisition advisory services, to the publishers, their successors, founders or creators, or to any of the issuers. Merrill Lynch may also act as market maker for the common stock of the issuers. A representative of an affiliate of Merrill Lynch may, from time to time, be a member of the STOXX Limited Advisory Committee, which advises the Supervisory Board on matters related to the ES50, including proposing changes in its composition and recommendations with respect to the accuracy and transparency of index computation. (Decision on the composition of and changes in the ES50 are reserved to the Supervisory Board.) At the present time, the Advisory Committee does not include any representatives of a Merrill Lynch affiliate.

As of April 30, 2004, the average daily trading volume for a single ES50 component was approximately 14.2 million shares.[17] As of the same date, the market capitalization of the components ranged from approximately 100 billion euros to approximately 10 billion euros. These figures corresponded approximately to 119.8 billion U.S. dollars and 11.98 billion U.S. dollars.

The highest-weighted stock in the ES50 has the weight of approximately 7.2%; all other components have lower weights. The top five stocks in the ES50 have the cumulative weight of approximately 25 percent.

In calculating the ES50, STOXX uses a divisor, currently equal to 500.424521, which represents the Index Aggregate Market Capitalization on the base date and which can be adjusted to allow changes in the issued share capital of individual underlying securities, including the deletion and addition of stocks, the substitution of stocks, stock dividends and stock splits, to be made without distorting the ES50.

Because Merrill Lynch, a broker-dealer, or its affiliate, may assist in maintaining the ES50, it is imperative that there be a functional separation, such as a firewall, between the trading desk of the broker-dealer and the research persons responsible for maintaining the ES50.[18] Merrill Lynch has represented that such a firewall exists. Moreover, Merrill

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17 This figure represents the average of the average numbers of shares of each ES50 component traded for the past 30 trading days. It is calculated by taking the sum of the volumes of the individual ES50 components for the past 30 trading days, dividing it by the total number of components (50), and then dividing the result by 30.

18 See Letter from Satch Chada, Director, Merrill Lynch, to Florence Harmon, Senior Special Counsel, Division, Commission, dated May 13, 2004.

Lynch also has represented that it has policies that prohibit the distribution of material, non-public information by its employees. [19]

The S&P 500 is published by Standard & Poor's, a division of The McGraw-Hill Companies, Inc. ("S&P") and is intended to provide an indication of the pattern of common stock price movement. The S&P 500 is a capitalization-weighted index, with each stock's weight proportionate to its market value. The value of the S&P 500 is based on the relative value of the aggregate market value of the common stocks of 500 companies as of a particular time compared to the aggregate average market value of the common stocks of 500 similar companies during the base period of the years 1941 through 1943. The market value for the common stock of a company is the product of the market price per share of the common stock and the number of outstanding shares of common stock. As of February 27, 2004, 424 companies or 84.3% of the market capitalization of the S&P 500 traded on the NYSE; 74 companies or 15.5% of the market capitalization of the S&P 500 traded on The Nasdaq National Market; and 2 companies or 0.2% of the market capitalization of the S&P 500 traded on the American Stock Exchange LLC ("Amex"). As of February 27, 2004, the aggregate market value of the 500 companies included in the S&P 500 represented approximately 77% of the aggregate market value of stocks included in the S&P Stock Guide Database of domestic common stocks traded in the U.S., excluding ADRs, limited partnerships and mutual funds. S&P selects companies for inclusion in the S&P 500 with the aim of achieving a distribution by broad industry groupings that approximates the distribution of these groupings in the common stock population of the S&P Stock Guide Database, which S&P uses as an

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[19] Id.

assumed model for the composition of the total market. Relevant criteria employed by S&P include the viability of the particular company, the extent to which that company represents the industry group to which it is assigned, the extent to which the market price of that company's common stock is generally responsive to changes in the affairs of the respective industry and the market value and trading activity of the common stock of that company. S&P may from time to time, in its sole discretion, add or delete companies to achieve the objectives stated above. The value of the S&P 500 is updated every 15 seconds.

As of March 30, 2004, the market capitalization of the securities included in the S&P 500 ranged from a high of approximately $308 billion to a low of approximately $931 million. The average daily trading volume for the S&P 500 over the previous six months, as of the same date, ranged from a high of approximately 28 million shares to a low of approximately 129,000 shares.

Nasdaq represents that NASD's surveillance procedures are adequate to properly monitor the trading of the Notes. Specifically, NASD will rely on its current surveillance procedures governing equity securities and will include additional monitoring on key pricing dates. The NASD represents that it is able to adequately surveil the trading activity of the underlying indexes to detect and deter manipulation. If manipulative activity or other types of trading activity that raise regulatory concerns are suspected and involve the Nikkei 225 component stocks, the NASD will rely on the Intermarket Surveillance Group ("ISG") Agreement to obtain the needed information from the TSE. This Agreement obligates the NASD and the TSE to compile and transmit market surveillance information and resolve in good faith any disagreements regarding requests for information or responses thereto. Also, if it ever became necessary (for example, if, hypothetically, the TSE withdrew from the ISG), NASD would seek the Commission's assistance pursuant to memoranda of understanding or similar inter-governmental agreements or arrangements that may exist between the Commission and the Japanese securities regulators.[20]

If manipulative activity or other types of trading activity that raise regulatory concerns are suspected and involve ES50 component stocks, then, in order to obtain the needed information, the NASD will also rely on the ISG Agreement to which the NASD and some of the ES50 markets are parties, on the memoranda of understanding ("MOUs") between the Commission and the relevant foreign regulators, and on information available domestically with respect to those issuers that list sponsored ADRs in the United States (the ISG Agreement, the MOUs and the sponsored ADRs are together referred to as the "Arrangements"). At present, in excess of 90% of the capitalization of the ES50 is subject to the Arrangements.[21]

Nasdaq will contact Commission staff regarding continued listing of the Notes linked to the Basket if: (i) the component securities representing more than 50% of the capitalization of the Basket are not subject to the Information Sharing Agreements

[20] Telephone conversation between Alex Kogan, Associate General Counsel, Nasdaq, and Florence Harmon, Senior Special Counsel, Division, Commission, dated May 7, 2004.

[21] Nasdaq represents that there is only one foreign stock exchange, HEX Helsinki, currently represented in the ES50 that is not subject either to the ISG Agreement with the NASD or to an MOU with the Commission. There is one ES50 stock that is currently listed on that exchange. This stock, Nokia, represents approximately 4 percent of the weight of the ES50, and has a sponsored ADR listed on the NYSE. Telephone conversation between Alex Kogan, Associate General Counsel, Nasdaq, and Hong-anh Tran, Special Counsel, Division, Commission, dated May 13, 2004.

("ISAs") with the NASD; or (ii) the components of the Basket representing more than 20% of the capitalization of the Basket and maintaining their primary listing on the same market are not subject to the ISAs with the NASD and the MOUs; or (iii) the components of the Basket representing more than 33 1/3 % of the capitalization of the Basket and maintaining their primary listing on one of the same two markets are not subject to the ISAs with the NASD.[22]

Since the Notes will be deemed equity securities for the purpose of NASD Rule 4420(f), the NASD and Nasdaq's existing equity trading rules will apply to the Notes. First, pursuant to NASD Rule 2310 and IM-2310-2, members must have reasonable grounds for believing that a recommendation to a customer regarding the purchase, sale or exchange of any security is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs.[23] In addition, as previously described, Nasdaq will distribute a circular to members providing guidance regarding compliance responsibilities and requirements, including suitability of recommendations, and highlighting the special risks and characteristics of the Notes. Furthermore, the Notes will be subject to the equity margin rules. Lastly, the regular equity trading hours of 9:30 am to 4:00 pm will apply to transactions in the Notes.

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22 Telephone conversation between Alex Kogan, Associate General Counsel, Nasdaq, and Hong-anh Tran, Special Counsel, Division, Commission, dated May 13, 2004.

23 Rule 2310(b) requires members to make reasonable efforts to obtain information concerning a customer's financial status, a customer's tax status, the customer's investment objectives, and such other information used or considered to be reasonable by such member or registered representative in making recommendations to the customer.

The providers of the indexes included in the Basket are not obligated to continue the calculation and dissemination of these indexes. In the event the calculation and dissemination of any of the three underlying indexes is discontinued, Nasdaq will consult with the Commission and will consider prohibiting the continued listing of the Notes.

Pursuant to Rule 10A-3 of the Act[24] and Section 3 of the Sarbanes-Oxley Act of 2002,[25] Nasdaq will prohibit the initial or continued listing of any security of an issuer that is not in compliance with the requirements set forth therein.

Merrill Lynch will deliver a prospectus in connection with the initial purchase of the Notes. The procedure for the delivery of a prospectus will be the same as Merrill Lynch's current procedure involving primary offerings.

2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 15A of the Act,[26] in general, and with Section 15A(b)(6) of the Act,[27] in particular, in that the proposal is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and, in general, to protect investors and the public interest. Specifically, the proposed rule change will provide investors with an investment vehicle based on the Basket.

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[24] 17 CFR 240.10A-3.

[25] See Section 3 of Pub. L. No. 107-204, 116 Stat. 745 (2002).

[26] 15 U.S.C. 78o-3.

[27] 15 U.S.C. 78o-3(b)(6).

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

Nasdaq 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. 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 No. SR-NASD-2004-061 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-NASD-2004-061. 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 the 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-2004-061 and should be submitted by [insert date 21 days from the date of publication in the Federal Register].

IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

Nasdaq requests that the Commission approve this filing on an accelerated basis since it raises no new or novel issues and will enable Nasdaq to accommodate the timetable of listing the Notes. In this regard, Nasdaq notes, and the Commission concurs, that the Commission has previously approved the listing of options on, and/or securities the performance of which has been linked to or based on the Nikkei,[28] the ES50,[29] and the

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[28] See Securities Exchange Act Release No. 38940 (August 15, 1997), 62 FR 44735 (August 22, 1997) (approving the listing and trading of Market Index Target-Term Securities, the return on which is based on changes in the value of a portfolio of 11 foreign indexes, including Nikkei).

[29] See Securities Exchange Act Release Nos. 40303 (August 4, 1998), 63 FR 42892 (August 11, 1998) (approving listing of BRoad InDex Guarded Equity-linked Securities linked to the value of the ES50); and 46021 (June 3, 2002), 67 FR

S&P 500.[30] The Commission has also previously approved the listing of securities with a structure that is the same or substantially the same as that of the Notes.[31]

After careful consideration, 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, and, in particular, with the requirements of Section 15A(b)(6) of the Act[32] in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market, and, in general, to protect investors and the public interest.[33] The Commission believes that the Notes will provide investors with a means of participating in the market for foreign securities. In particular, the Commission believes that the Notes

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39753 (June 10, 2002) (approving listing of notes based on the Dow Jones EURO STOXX 50 Return Index, which is based on the ES50).

30 See Securities Exchange Act Release Nos. 48677 (October 21, 2003), 68 FR 61524 (October 28, 2003) (approving the listing and trading of Accelerated Return Notes linked to the S&P 500); 47464 (March 7, 2003), 68 FR 12116 (March 13, 2003) (approving the listing and trading of Market Recovery Notes Linked to the S&P 500); 30394 (February 21, 1992), 57 FR 7409 (March 2, 1992) (approving the listing and trading of a unit investment trust linked to the S&P 500); 27382 (October 26, 1989), 54 FR 45834 (October 31, 1989) (approving the listing and trading of Exchange Stock Portfolios based on the value of the S&P 500); 31591 (December 11, 1992), 57 FR 60253 (December 18, 1992) (approving the listing and trading of Portfolio Depositary Receipts based on the S&P 500); and 19907 (June 24, 1983), 48 FR 30814 (July 5, 1983) (approving the listing and trading of options on the S&P 500).

31 See Securities Exchange Act Release Nos. 49301 (Feb. 23, 2004), 69 FR 9665 (March 1, 2004) (approving the listing and trading of 97% protected notes linked to the Dow Jones Industrial Average); 48152 (July 10, 2003), 68 FR 42435 (July 17, 2003) (approving the listing and trading of partial principal protected notes linked to the S&P 500); and 48486 (Sept. 11, 2003), 68 FR 54758 (Sept. 18, 2003) (approving the listing and trading of contingent principal protection notes linked to the S&P 500).

32 15 U.S.C. 78o-3(b)(6).

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

will permit investors to obtain returns based on the S&P 500 as well as returns based on the component foreign markets while at the same time limiting the downside risk of the original investment as a result of the principal guarantee. The Notes are securities that entitle the holder to receive from the issuer upon maturity a pre-established percentage of the principal amount of the Notes plus an amount based upon the increase in the market value of the Basket, if any. Specifically, the Commission notes that the Notes provide for the return of at least 97% of the principal amount per Unit. As described more fully above, if the value of the Basket decreases or does not increase sufficiently, a beneficial owner will be entitled to less than the principal amount of $10 per Unit. However, in no event will a beneficial owner be entitled to less than the Minimum Redemption Amount.

The Notes are a series of senior non-convertible debt securities whose price will be based on the value of the Basket. The Notes do not guarantee that the total amount at maturity will be equal to the principal amount. Thus, if the Basket has declined at maturity, a beneficial owner may receive 3% less than the original public offering price of the Notes. Because the final rate of return on the Notes is derivatively priced and based upon the performance of the value of three different indexes, two of which are foreign indexes, comprising the Basket, and because the Participation Rate limits investors' potential return, there are several issues regarding the trading of this type of product. For the reasons discussed below, the Commission believes that Nasdaq's proposal adequately addresses the concerns raised by this type of product.

First, the Commission notes that the protections of NASD Rule 4420(f) were designed to address the concerns attendant to the trading of hybrid securities like the

Notes.[34] In particular, by imposing the hybrid listing standards, heightened suitability for recommendations,[35] and compliance requirements, noted above, the Commission believes that Nasdaq has adequately addressed the potential problems that could arise from the hybrid nature of the Notes. The Commission notes that Nasdaq will distribute a circular to its membership that provides guidance regarding member firm compliance responsibilities and requirements, including suitability recommendations, and highlights the special risks and characteristics associated with the Notes. Specifically, among other things, the circular will indicate that the Notes do not guarantee a total return of principal at maturity, that the Participation Rate on the Notes is expected to be between 100% and 105% per Unit,[36] that the Notes will not pay interest, and that the Notes will provide exposure in the indexes comprising the Basket. Distribution of the circular should help to ensure that only customers with an understanding of the risks attendant to the trading of the Notes and who are able to bear the financial risks associated with transactions in the Notes will trade the Notes. In addition, the Commission notes that Merrill Lynch will deliver a prospectus in connection with the initial purchase of the Notes.

Second, the Commission notes that the final rate of return on the Notes depends, in part, upon the individual credit of the issuer, Merrill Lynch. To some extent this credit risk is minimized by the NASD's listing standards in NASD Rule 4420(f), which provide

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34 See 1993 Order, supra note 4.

35 As discussed above, Nasdaq will advise members recommending a transaction in the Notes to: (1) determine that the transaction is suitable for the customer; and (2) have a reasonable basis for believing that the customer can evaluate the special characteristics of, and is able to bear the financial risks of, the transaction.

36 The Commission notes that the actual Participation Rate on the day the Notes are priced for initial sale to the public will be disclosed in the final prospectus supplement.

that only issuers satisfying substantial asset and equity requirements may issue these types of hybrid securities. In addition, the NASD's hybrid listing standards further require that the Notes have at least $4 million in market value. Financial information regarding Merrill Lynch, in addition to information concerning the issuers, in addition to information on the underlying indexes, will be publicly available.

Third, the Notes will be registered under Section 12 of the Act. As noted above, the NASD's and Nasdaq's existing equity trading rules will apply to the Notes, which will be subject to equity margin rules and will trade during the regular equity trading hours of 9:30 a.m. to 4:00 p.m. NASD Regulation's surveillance procedures for the Notes will be the same as its current surveillance procedures for equity securities, and will include additional monitoring on key pricing dates.

Fourth, the Commission has a systemic concern that a broker-dealer, such as Merrill Lynch, or a subsidiary providing a hedge for the issuer will incur position exposure. However, as the Commission has concluded in previous approval orders for the hybrid instruments issued by broker-dealers, [37] the Commission believes that this concern is minimal given the size of the Notes issuance in relation to the net worth of Merrill Lynch.

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37 See, e.g., Securities Exchange Act Release Nos. 44913 (October 9, 2001), 66 FR 52469 (October 15, 2001) (order approving File No. SR-NASD-2001-73) (approving the listing and trading of notes issued by Morgan Stanley Dean Witter & Co. whose return is based on the performance of the Index); 44483 (June 27, 2001), 66 FR 35677 (July 6, 2001) (order approving File No. SR-Amex-2001-40) (approving the listing and trading of notes issued by Merrill Lynch whose return is based on a portfolio of 20 securities selected from the Amex Institutional Index); and 37744 (September 27, 1996), 61 FR 52480 (October 7, 1996) (order approving File No. SR-Amex-96-27) (approving the listing and trading of notes issued by Merrill Lynch whose return is based on a weighted portfolio of healthcare/biotechnology industry securities).

Fifth, the Commission believes that the listing and trading of the Notes should not unduly impact the market for the securities underlying the Basket or raise manipulative concerns. In approving the Notes, the Commission recognizes that the Basket measures the value of the equity securities of companies listed on various U.S. (i.e., the S&P 500), European (i.e., the ES50), and Asian (i.e., the Nikkei) exchanges. In particular, the Commission notes that the S&P 500 is a capitalization-weighted index of 500 companies listed on Nasdaq, the NYSE and the Amex. The Commission notes that the S&P 500 is determined, composed, and calculated by S&P. As of March 30, 2004, the market capitalization of the securities included in the S&P 500 ranged from a high of approximately $308 billion to a low of approximately $931 million. The average daily trading volume for the S&P 500 over the previous six months, as of the same date, ranged from a high of approximately 28 million shares to a low of approximately 129,000 shares. As of February 27, 2004, the aggregate market value of the 500 companies included in the S&P 500 represented approximately 77% of the aggregate market value of stocks included in the S&P Stock Guide Database of domestic common stocks traded in the U.S., excluding ADRs, limited partnerships and mutual funds. S&P chooses companies for inclusion in the Index with the aim of achieving a distribution by broad industry groupings that approximates the distribution of these groupings in the common stock population of the S&P's Stock Guide Database.

Further, the ES50, a market-capitalization weighted index, was created and is published by STOXX, a joint venture founded by SWX-Swiss Exchange, SBF-Bourse de Paris, Deutsche Borse AG and Dow Jones & Company. The following stock markets are currently the primary listing markets for the ES50 components: Deutsche Borse (21.3%

of the ES50 weight), Euronext Amsterdam (18.2%),[38] Borsa Italiana (10.9%), Euronext Paris (32.2%), the Spanish Stock Market (13.1%) and HEX Helsinki (4%). In addition, Nasdaq represents that a number of the ES50 components are traded on more than one major European market. In addition, 34 of the 50 ES50 issuers currently have sponsored ADRs listed on the NYSE, and 4 have non-sponsored ADRs trading in the United States. Thus, the Commission notes that the companies that are included in the ES50 are representative of a broad market and a wide array of European industries. As of April 30, 2004, the average daily trading volume for a single ES50 component was approximately 14.2 million shares.[39] As of the same date, the market capitalization of the components ranged from approximately 100 billion euros to approximately 10 billion euros. These figures corresponded approximately to 119.8 billion U.S. dollars and 11.98 billion U.S. dollars.

Moreover, the Commission notes that the Nikkei, a modified, price-weighted index, measures the composite price performance of 225 underlying common stocks traded on the TSE, and represents a broad cross-section of Japanese industry. All 225 underlying stocks are listed in the First Section of the TSE and are, therefore, among the most actively traded stocks on the TSE. As of April 30, 2004, the average daily trading

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38 One of the component stocks with a primary listing in Amsterdam maintains a second "primary listing" on Euronext Brussels. This component comprises approximately 1.6% of the total ES50 weight.

39 This figure represents the average of the average number of shares of each ES50 component traded for the past 30 trading days. It is calculated by taking the sum of the volumes of the individual ES50 components for the past 30 trading days, dividing it by the total number of components (50), and then dividing the result by 30.

volume for a single Nikkei component was approximately 4.8 million shares.[40] As of the same date, the market capitalization of the components ranged from 14.4 trillion yen to 33.7 billion yen. These figures correspond approximately to 130 billion U.S. dollars and 305 million U.S. dollars.

Given that all three indexes comprising the Basket are highly-capitalized and contain diversified securities listed on various U.S., European, and Asian exchanges, the Commission believes that the listing and trading of the Notes that are linked to the Basket should not unduly impact the market for the securities underlying the three indexes comprising the Basket or raise manipulative concerns. The Commission notes that all of the indexes underlying the Basket are established indexes. However, in light of the fact that the Nikkei and the ES50 are foreign indexes, the Commission believes adequate information sharing agreements with foreign regulators are a necessary prerequisite to deter as well as detect any potential manipulation or other improper or illegal trading involving the Notes. While many of the issuers of the underlying securities comprising the Nikkei 225 are not subject to reporting requirements under the Act, Nasdaq represents that an adequate surveillance sharing agreement exists through the ISG between the NASD and the TSE to deter and detect potential manipulations or other improper trading in the underlying components. Therefore, Nasdaq's surveillance procedures will serve to deter as well as detect any potential manipulation. This agreement obligates the NASD and TSE to compile and transmit market surveillance information and resolve in good faith any disagreements regarding requests for information. Accordingly, the

[40] This figure represents the average number of shares traded for the past 30 trading days. It is calculated by taking the sum of the volumes of the individual Nikkei components for the past 30 trading days and dividing it by 30.

Commission believes that the surveillance sharing agreement through ISG is adequate for the NASD to surveil the components of the Nikkei 225 for potential manipulation or other trading abuses between the markets with respect to the trading of the Notes based on the Nikkei 225. Nasdaq further represents that it will rely on the ISG Agreement to which the NASD and some of the ES50 markets are parties, on the MOUs between the Commission and the relevant foreign regulators, and on information available domestically with respect to those issuers that list sponsored ADRs in the United States (the ISG Agreement, the MOUs and the sponsored ADRs are together referred to as the "Arrangements"). At present, Nasdaq represents that in excess of 90% of the capitalization of the ES50 is subject to the Arrangements. In addition, if the surveillance coverage for the ES50 falls below certain levels, as discussed above, Nasdaq will contact the Commission staff regarding continued listing of the Notes linked to the Basket. This should help to ensure that adequate surveillance mechanisms exist in the future.

Finally, the Commission notes that the values of the Nikkei, the ES50, and the S&P 500 indexes will be disseminated at least once every minute for the Nikkei, and once every 15 seconds for the ES50 when the European markets are open and the S&P 500 throughout the trading day. The Commission believes that providing real time access to the value of these indexes throughout the trading day is sufficient and will provide benefits to investors in the Notes.

The Commission finds good cause for approving the proposed rule change, as amended, prior to the thirtieth day after the date of publication of notice of filing thereof in the Federal Register. The Commission believes that the Notes will provide investors with an additional investment choice and that accelerated approval of the proposal will allow investors to begin trading the Notes promptly. In addition, the Commission notes that it has previously approved the listing of options on, and/or securities the performance of which has been linked to or based on the Nikkei,[41] the ES50,[42] and the S&P 500.[43] The Commission has also previously approved the listing of securities with a structure that is the same or substantially the same as that of the Notes.[44]

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41 See Securities Exchange Act Release No. 38940 (August 15, 1997), 62 FR 44735 (August 22, 1997) (approving the listing and trading of Market Index Target-Term Securities, the return on which is based on changes in the value of a portfolio of 11 foreign indexes, including Nikkei).

42 See Securities Exchange Act Release Nos. 40303 (August 4, 1998), 63 FR 42892 (August 11, 1998) (approving listing of BRoad InDex Guarded Equity-linked Securities linked to the value of the ES50); and 46021 (June 3, 2002), 67 FR 39753 (June 10, 2002) (approving listing of notes based on the Dow Jones EURO STOXX 50 Return Index, which is based on the ES50).

43 See Securities Exchange Act Release Nos. 48677 (October 21, 2003), 68 FR 61524 (October 28, 2003) (approving the listing and trading of Accelerated Return Notes linked to the S&P 500); 47464 (March 7, 2003), 68 FR 12116 (March 13, 2003) (approving the listing and trading of Market Recovery Notes Linked to the S&P 500); 30394 (February 21, 1992), 57 FR 7409 (March 2, 1992) (approving the listing and trading of a unit investment trust linked to the S&P 500); 27382 (October 26, 1989), 54 FR 45834 (October 31, 1989) (approving the listing and trading of Exchange Stock Portfolios based on the value of the S&P 500); 31591 (December 11, 1992), 57 FR 60253 (December 18, 1992) (approving the listing and trading of Portfolio Depositary Receipts based on the S&P 500); and 19907 (June 24, 1983), 48 FR 30814 (July 5, 1983) (approving the listing and trading of options on the S&P 500).

44 See Securities Exchange Act Release Nos. 49301 (Feb. 23, 2004), 69 FR 9665 (March 1, 2004) (approving the listing and trading of 97% protected notes linked to the Dow Jones Industrial Average); 48152 (July 10, 2003), 68 FR 42435 (July 17, 2003) (approving the listing and trading of partial principal protected notes linked to the S&P 500); and 48486 (Sept. 11, 2003), 68 FR 54758 (Sept. 18, 2003) (approving the listing and trading of contingent principal protection notes linked to the S&P 500).

Thus, the Commission believes that the proposal does not raise any new regulatory issues. Accordingly, the Commission believes that there is good cause, consistent with Sections 15A(b)(6) and 19(b)(2) of the Act[45] to approve the proposal, on an accelerated basis.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[46] that the proposed rule change (SR-NASD-2004-061) is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[47]

Margaret H. McFarland
Deputy Secretary

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[45] 15 U.S.C. 78o-3(b)(6) and 78s(b)(2).

[46] 15 U.S.C. 78s(b)(2).

[47] 17 CFR 200.30-3(a)(12).