SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-50916; File No. SR-NASD-2004-188)

December 22, 2004

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to the Listing and Trading of Performance Leveraged Upside Securities Based on the Value of the Index

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 December 21, 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 and II below, which Items have been prepared by Nasdaq. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and is approving the proposal on an accelerated basis.

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

The Nasdaq proposed to list notes, know as Performance Leveraged Upside Securities[SM] ("Notes") issued by Morgan Stanley ("Morgan Stanley"), the performance of which is linked to the Nasdaq-100 ("Nasdaq-100" or "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, the Nasdaq included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it

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

2 17 CFR 240.19b-4.

received on the proposed rule change. The text of these statements may be examined at the places specified in Item III below. The 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 Performance Leveraged Upside Securities ("PLUS"), the return on which is based upon the Nasdaq-100 Index (the "Index").[3]

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[3] The Index is a modified capitalization-weighted index of 100 of the largest non-financial companies listed on The Nasdaq National Market tier of The Nasdaq Stock Market. The Index constitutes a broadly diversified segment of the largest securities listed on The Nasdaq Stock Market and includes companies across a variety of major industry groups. The securities in the Index must, among other things, have an average daily trading volume on Nasdaq of at least 200,000 shares.

In order to ensure that there is no domination of the Index by a few large stocks, the Index is calculated under a "modified capitalization-weighted" methodology, which is a hybrid between equal weighting and conventional capitalization weighting. Under the methodology employed, on a quarterly basis coinciding with Nasdaq's quarterly scheduled weight adjustment procedures, the Index Securities are categorized as either "Large Stocks" or "Small Stocks" depending on whether their current percentage weights (after taking into account such scheduled weight adjustments due to stock repurchases, secondary offerings, or other corporate actions) are greater than, or less than or equal to, the average percentage weight in the Index (i.e., as a 100-stock index, the average percentage weight in the Index is 1.0%). Such quarterly examination will result in an Index rebalancing if either one or both of the following two weight distribution requirements are not met: (1) the current weight of the single largest market capitalization Index component security must be less than or equal to 24.0%, and (2) the "collective weight" of those Index component securities whose individual current weights are in excess of 4.5%, when added together, must be less than or equal to 48.0%.

Index securities are ranked by market value and are evaluated annually to determine which securities will be included in the Index. Moreover, if at any time during the year an Index security is no longer trading on the Nasdaq Stock Market, or is otherwise determined by Nasdaq to become ineligible for continued

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

(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;

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inclusion in the Index, the security will be replaced with the largest market capitalization security not currently in the Index that meets the Index eligibility criteria.

For a detailed description of the Index, see the prospectus supplement that will be filed by Morgan Stanley with the Commission prior to the issuance of the Notes. The Index is widely disseminated at Bloomberg, Reuters and Thomson Financial, where its value is updated every 15 seconds during normal trading hours. In the event that the calculation and this type of dissemination of the Index is discontinued, Nasdaq will delist the notes.

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

5 Morgan Stanley satisfies this listing criterion.

(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;

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

In addition, Morgan Stanley 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: (1) determine that such 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, such transaction.

The Notes will be subject to Nasdaq's continued listing criterion for other securities pursuant to NASD 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

[6] NASD Rule 4420(f)(2) requires issuers of securities designated pursuant to this paragraph to be listed on The Nasdaq National Market or the New York Stock Exchange ("NYSE") or be an affiliate of a company listed on The Nasdaq National Market 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.

also must have at least two registered and active market makers as required by NASD Rule 4310(c)(1). The Notes will be subject to the NASD's existing trading halt rules. Nasdaq will also consider prohibiting the continued listing of the Notes if Morgan Stanley is not able to meet its obligations on the Notes.

The Notes are a series of medium-term, senior non-convertible debt securities that will be issued by Morgan Stanley. The original public offering price of the Notes will be $10 per PLUS. The Notes will not pay interest and are not subject to redemption by Morgan Stanley or at the option of any beneficial owner before maturity on March 30, 2006.

At maturity, if the value of the Index has increased, a beneficial owner will be entitled to receive a payment on the Notes based on 200% the amount of that percentage increase, subject to a maximum total payment at maturity that is expected to be between $11.50 and $11.70 (the "Maximum Payment at Maturity").[7] Thus, the Notes provide investors the opportunity to obtain leveraged returns based on the Index subject to a cap that is expected to represent an appreciation of 15% to 17% over the original issue price of the Notes. Unlike ordinary debt securities, the Notes do not guarantee any return of principal at maturity. Therefore, if the value of the Index has declined at maturity, a beneficial owner will receive less, and possibly significantly less, than the original issue price of $10 per PLUS.

The payment that a beneficial owner will be entitled to receive at maturity depends entirely on the relation of the value of the Index on March 30, 2006 (the "Final

[7] The actual Maximum Payment at Maturity will be determined at the time of issuance of the Notes.

Index Value") and the value of the Index on the day the PLUS is offered for initial sale to the public (the "Initial Index Value"). If the Final Index Value is greater than the Initial Index Value, the payment at maturity per PLUS will equal the lesser of (a) $10 plus the Leveraged Upside Payment[8] and (b) the Maximum Payment at Maturity. If the Final Index Value is less than or equal to the Initial Index Value, the payment at maturity per PLUS will equal $10 times the Index Performance Factor.[9]

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 Index. The Commission has previously approved the listing of options on, and other securities the performance of which have been linked to or based on, the Index.[10]

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8 The Leveraged Upside Payment is the product of (i) $10 and (ii) 200% and (iii) the Index Percent Increase (a fraction, the numerator of which is the Final Index Value minus the Initial Index Value and the denominator of which is the Initial Index Value).

9 The Index Performance Factor is a fraction, the numerator of which is the Final Index Value and the denominator of which is the Initial Index Value.

10 See Securities Exchange Act Release Nos. 48065 (June 19, 2003), 68 FR 38414 (June 27, 2003) (approving the listing and trading of Performance Leveraged Upside Securities based on the Value of the Nasdaq-100 Index); 45429 (February 11, 2002), 67 FR 7438 (February 19, 2002) (approving the listing and trading of Enhanced Return Notes Linked to the Nasdaq-100 Index); 45024 (November 5, 2001), 66 FR 56872 (November 13, 2001) (approving the listing and trading of Enhanced Return Notes Linked to the Nasdaq-100 Index); 44913 (October 9, 2001), 66 FR 52469 (October 15, 2001) (approving the listing and trading of Performance Leveraged Upside Securities based upon the performance of the Nasdaq-100 Index); 43000 (June 30, 2000), 65 FR 42409 (July 10, 2000) (approving the listing and trading of options based upon one-tenth of the value of the Nasdaq-100 Index); 41119 (February 26, 1999), 64 FR 11510 (March 9, 1999) (approving the listing and trading of Portfolio Depositary Receipts based on the Nasdaq-100 Index); and 33428 (January 5, 1994), 59 FR 1576 (January 11, 1994) (approving the listing and trading of options on the Nasdaq-100 Index).

As of the close of business on December 17, 2004, the adjusted market capitalization of the securities included in the Index ranged from a high of $188.2 billion to a low of $3.7 billion. As of the same date, the average daily trading volume for these same securities since the beginning of 2004 ranged from a high of 67.1 million shares to a low of 416,6000 shares.

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.[11] In addition, as previously described, 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. 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.

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

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[11] NASD 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.

procedures governing equity securities, and will include additional monitoring on key pricing dates.

Pursuant to Rule 10A-3 of the Act and Section 3 of the Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002), 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.

Morgan Stanley 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 Morgan Stanley'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,[12] in general, and with Section 15A(b)(6) of the Act,[13] 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.

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, as amended.

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[12] 15 U.S.C. 78o-3.

[13] 15 U.S.C. 78o-3(6).

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 Number SR-NASD-2004-188 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-2004-188. 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 Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such 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-2004-188 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

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

After careful consideration, the Commission finds that the proposed rule change 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.[14] The Commission has previously approved the listing of options on, and securities the performance of which have been linked to or based on the Index.[15] Accordingly, the Commission finds that listing and trading of the Notes is consistent with the Act and will promote just and equitable principles of trade, foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, in general, to protect investors and the public interest.[16]

The requirements of NASD Rule 4420(f) were designed to address the concerns attendant to the trading of hybrid securities like the Notes. NASD Rule 4420(f)(2)

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14 15 U.S.C. 78o-3(b)(6).

15 Supra note 10.

16 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).

provides that only issuers satisfying substantial asset and equity requirements may issue securities such as the Notes. In addition, Nasdaq's continued listing criterion for other securities further require that the Notes have a market value of at least $4 million.[17] The Commission also notes that the 100 component stocks that comprises the Index are reporting companies under the Act, and the Notes will be registered under Section 12 of the Act. Thus, by imposing the hybrid listing standards, suitability, disclosure, and compliance requirements noted above, the Commission believes the Nasdaq has addressed adequately the potential problems that could arise from the hybrid nature of the Notes.

In approving the product, the Commission recognizes that the Index is a modified capitalization-weighted index[18] of 100 of the largest and most active non-financial domestic and international companies listed on Nasdaq. Given the large trading volume and capitalization of the compositions of the stocks underlying the Index, the Commission believes that the listing and trading of the Notes that are linked to the Index should not unduly impact the market for the underlying securities compromising the Index or raise manipulative concerns.[19] Moreover, the issuers of the underlying securities comprising the Index are subject to reporting requirements under the Act, and all of the component stocks are either listed or traded on, or traded through the facilities of, U.S.

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17 See NASD Rule 4450(c).

18 See supra Note 3.

19 The issuer Morgan Stanley disclosed in the prospectus that the original issue price of the Notes includes commissions (and the secondary market prices are likely to exclude commissions) and Morgan Stanley's costs of hedging its obligations under the Notes. These costs could increase the initial value of the Notes, thus affecting the payment investors receive at maturity. Such hedging activity must, of course, be conducted in accordance with applicable regulatory requirements.

securities markets.

The Commission also believes that any concerns that a broker-dealer, such as Morgan Stanley or a subsidiary providing a hedge for the issuer, will incur undue position exposure are minimized by the size of the Notes issuance in relation to the net worth of Morgan Stanley.[20]

Finally, the Commission notes that the value of the Index will be widely disseminated at least once fifteen seconds throughout the trading day. Nasdaq represents that the Nasdaq-100 will be determined, calculated and maintained solely by Nasdaq.

The Commission finds good cause for approving the proposed rule change prior to the 30th day after the date of publication of the notice of filing thereof in the Federal Register. Nasdaq has requested accelerated approval because this product is similar to several other instruments currently listed and traded on the Nasdaq.[21] 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

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[20] See Securities Exchange Act Release Nos. 44913 (October 9, 2001), 66 FR 52469 (October 15, 2001) (order approving the listing and trading of notes whose return is based on the performance of the Nasdaq-100 Index) (File No. SR-NASD-2001-73); 44483 (June 27, 2001), 66 FR 35677 (July 6, 2001) (order approving the listing and trading of notes whose return is based on a portfolio of 20 securities selected from the Amex Institutional Index) (File No. SR-Amex-2001-40); and 37744 (September 27, 1996), 61 FR 52480 (October 7, 1996) (order approving the listing and trading of notes whose return is based on a weighted portfolio of healthcare/biotechnology industry securities) (File No. SR-Amex-96-27).

[21] See Securities Exchange Act Release Nos. 45966 (May 20, 2002), 67 FR 36942 (May 28, 2002) (approval to list and trade notes linked to the performance of the Nasdaq-100); 47911 (May 22, 2003), 68 FR 32558 (May 30, 2003) (approving the listing and trading of notes (Wachovia TEES) linked to the S&P 500); 47983 (June 4, 2003), 68 FR 35032 (June 11, 2003) (approving the listing and trading of a CSFB Accelerated Return Notes linked to S&P 500); and 50019 (July 14, 2004), 69 FR 43635 (July 21, 2004) (approving the listing and trading of Morgan Stanley PLUS Notes).

promptly. Additionally, the Notes will be listed pursuant to Nasdaq's existing hybrid security listing standards as described above. Therefore, the Commission finds good cause, consistent with Section 19(b)(2) of the Act,[22] to approve the proposal on an accelerated basis.

Accordingly, the Commission believes there is good cause, consistent with Sections 15A(b)(6) and 19(b)(2) of the Act,[23] to approve the proposal, on an accelerated basis.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[24] that the proposed rule change (SR-NASD-2004-188) is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[25]

Margaret H. McFarland
Deputy Secretary

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[22] 15 U.S.C. 78f(b)(5) and 78s(b)(2).

[23] 15 U.S.C. 78o3(b)(6) and 78s(b)(2).

[24] 15 U.S.C. 78s(b)(2).

[25] 17 CFR 200.30-3(a)(12).