

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51123; File No. SR-NASD-2004-169)

February 2, 2005

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Granting Approval to Proposed Rule Change and Amendment No. 3 Thereto to Adopt Additional Listing Standards Applicable to the Securities of The Nasdaq Stock Market, Inc. or an Affiliate

I. Introduction

On November 2, 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 adopt additional listing standards that would apply to securities of Nasdaq or its affiliate listed on The Nasdaq Stock Market. On December 14, 2004, and December 15, 2004, Nasdaq filed Amendments No. 1 and No. 2, respectively.³ On December 15, 2004, Nasdaq filed Amendment No. 3 to the proposal.⁴ The proposed rule change was published for notice and comment in the Federal Register on December 29, 2004.⁵ The Commission received no comments on the proposal. This order approves the proposed rule change, as amended.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 and Amendment No. 2 were deficient for technical reasons and were withdrawn on December 14 and December 15, 2004, respectively.

⁴ Amendment No. 3 slightly modified the text of the proposed rule to make clear that the exclusion in the definition of an Affiliate Security would encompass both portfolio depository receipts and index fund shares. The amendment also further clarifies and explains the proposed rule change. Amendment No. 3 was incorporated into the notice.

⁵ See Securities Exchange Act Release No. 50897 (December 21, 2004), 69 FR 78076.

II. Description of the Proposal

Nasdaq proposes to adopt new Rule 4370 that would impose additional reporting requirements on Nasdaq should Nasdaq or an affiliate of Nasdaq (collectively, the “Nasdaq Affiliates” or “Nasdaq Affiliate”)⁶ list a security on The Nasdaq Stock Market. In the event that a Nasdaq Affiliate lists a security on The Nasdaq Stock Market (the “Affiliate Security”), the proposed rule change would require Nasdaq to file a report with the Commission on a monthly basis detailing Nasdaq’s monitoring of (1) the Nasdaq Affiliate’s compliance with the provisions of the Rule 4200, 4300 and 4400 Series,⁷ and (2) the trading of the Affiliate Security, including summaries of all related surveillance alerts, complaints, regulatory referrals, trades cancelled or adjusted pursuant to NASD Rule 11890, investigations, examinations, formal and informal disciplinary actions, exception reports and trading data.

Nasdaq also would be required to notify the Commission at the same time it notifies the Nasdaq Affiliate if Nasdaq determines that the Nasdaq Affiliate was not in compliance with any of its listing standards. Nasdaq would be required to notify the Commission within five business days of its receipt of a plan of compliance from the Nasdaq Affiliate and advise the Commission on whether the plan of compliance was accepted by Nasdaq or what other action was taken with respect to the plan, and the time period provided to regain compliance with the Rule 4200, 4300 and 4400 Series, if any.

⁶ The NASD currently would be considered a Nasdaq Affiliate for purposes of the proposed rule change.

⁷ These rules include quantitative (minimum bid price, number of round lot holders, number of publicly held shares, market value, etc.) and qualitative (concerning independent directors, audit committee, shareholder meetings, etc.) requirements for initial and continued inclusion of securities in The Nasdaq Stock Market, as well as issuer designation requirements.

In addition, Nasdaq would be required to commission an annual review and report by an independent accounting firm of the compliance of the Affiliate Security with the Rule 4200, 4300 and 4400 Series. Nasdaq would be required to furnish promptly a copy of the report to the Commission.

Solely for the purposes of Rule 4370, Nasdaq proposes to exclude from the definition of “Affiliate Security” securities that meet the definition of “Portfolio Depository Receipts” under NASD Rule 4420(i)(1)(A) and “Index Fund Shares” under NASD Rule 4420(j)(1)(A).⁸

Nasdaq believes that the additional requirements contained in Rule 4370 would provide additional assurance that any securities listed on The Nasdaq Stock Market by a Nasdaq Affiliate comply with Nasdaq’s listing standards on an on-going basis. Nasdaq believes that the proposed rule change would eliminate any perception of a potential conflict of interest if a Nasdaq Affiliate seeks to list a security on The Nasdaq Stock Market.

III. Discussion and Commission Findings

The Commission has reviewed carefully the proposed rule change, as amended, and finds that it is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.⁹ In particular, the Commission believes that the proposal, as amended, is consistent with Section 15A(b)(6) of the Act,¹⁰ which requires that an association’s rules be designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, remove impediments to, and perfect the mechanism of, a free and open market and, in general, protect investors and the public interest.

⁸ These securities are types of exchange-traded funds (“ETFs”).

⁹ In approving this proposed rule change, the Commission has considered the proposed rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹⁰ 15 U.S.C. 78o-3(b)(6).

The Commission also finds that the proposed rule change, as amended, is consistent with Section 15A(b)(2) of the Act,¹¹ which requires a national securities association to be so organized and have the capacity to be able to carry out the purposes of the Act and to enforce compliance by its members and persons associated with its members with the provisions of the Act, the rules and regulations thereunder, and the rules of the association.

The listing of an Affiliate Security on The Nasdaq Stock Market could potentially create a conflict of interest between the NASD's, Nasdaq's, and NASD Regulation, Inc.'s ("NASDR") regulatory responsibilities to vigorously oversee the listing and trading of an Affiliate Security on The Nasdaq Stock Market, and their own commercial or economic interests. Such "self-listing" may raise questions as to the NASD's, Nasdaq's, and NASDR's ability to independently and effectively enforce the Commission's and the NASD's rules against an affiliate of Nasdaq. In addition, such listing has the potential to exacerbate possible conflicts that may arise when these entities oversee competitors that may also be listed on The Nasdaq Stock Market.

The Commission believes that the proposed rule change, by requiring heightened reporting by Nasdaq to the Commission with respect to oversight of the listing and trading on The Nasdaq Stock Market of an Affiliate Security, will help protect against concerns that Nasdaq will not effectively enforce its rules with respect to the listing and trading of these securities. In addition, the requirement that an independent accounting firm review such issuer's compliance with Nasdaq's listing standards adds a degree of independent oversight to Nasdaq's regulation of the listing of these securities, which may mitigate any potential or actual conflicts of interest.¹²

¹¹ 15 U.S.C. 78o-3(b)(2).

¹² On December 8, 2004, the Commission published for comment a proposed rulemaking that would impose reporting and other requirements on a self-regulatory organization ("SRO") that chooses to list or trade its own securities, the securities of any trading facility, the securities of an affiliate of the SRO, or the securities of an affiliate of a

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹³ that the proposed rule change (File No. SR-NASD-2004-169), as amended, be and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁴

Margaret H. McFarland
Deputy Secretary

trading facility of the SRO. Unlike the NASD's proposed rule change, the Commission's proposed rule would apply to investment companies that track an index, such as exchange-traded funds. See Securities Exchange Act Release No. 50699, 69 FR 71126 (December 8, 2004). The NASD would, of course, have to conform its rules to any rules the Commission may adopt in the future.

¹³ 15 U.S.C. 78s(b)(2).

¹⁴ 17 CFR 200.30-3(a)(12).