

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-49783; File No. SR-NASD-2004-065)

May 27, 2004

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Regarding the Nasdaq Closing Cross

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on April 19, 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”) the proposed rule change as described in Items I, II, and III 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.

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

The proposed rule change would amend NASD Rule 4709 governing the NASDAQ Closing Cross. Specifically, Nasdaq is proposing to clarify that market participants would not be able to cancel Imbalance Only orders (“IOs”), Market on Close orders (“MOC”), or Limit on Close orders (“LOC”) after 3:50 p.m. EST except to correct a legitimate error, including side, size, symbol, price or duplication of an order. The text of the proposed rule change is set forth below. Proposed new language is in *italics*; proposed deletions are in [brackets].

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4709. Nasdaq Closing Cross

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

(a) **Definitions.** For the purposes of this rule the term:

(1) No Change.

(2) “Imbalance Only Order” or “IO” shall mean an order to buy or sell at a specified price or better that may be executed only during the Nasdaq Closing Cross and only against MOC or LOC orders. IO orders can be entered between 3:30 p.m. and 3:59:59 p.m., but they cannot be [cancelled or] modified after 3:50:00 except to increase the number of shares or to increase (decrease) the buy (sell) limit price. IO orders can be cancelled between 3:50:00 p.m. and 3:55:00 p.m. only by requesting Nasdaq to correct a legitimate error (e.g., side, size, symbol, price or duplication of an order). IO orders cannot be cancelled after 3:55:00 p.m. for any reason. IO sell (buy) orders will only execute at or above (below) the 4:00:00 SuperMontage offer (bid). All IO orders must be available for automatic execution.

(3) “Limit On Close Order” or “LOC” shall mean an order to buy or sell at a specified price or better that is to be executed only during the Nasdaq Closing Cross. LOC orders can be entered, cancelled, and corrected between 9:30:01 a.m. and 3:50:00 p.m. LOC orders can be cancelled between 3:50:00 p.m. and 3:55:00 p.m. only by requesting Nasdaq to correct a legitimate error (e.g., side, size, symbol, price or duplication of an order). LOC orders cannot be cancelled after 3:55:00 p.m. for any reason. LOC Orders will execute only at the price determined by the Nasdaq Closing Cross. All LOC orders must be available for automatic execution.

(4) “Market on Close Order” shall mean an order to buy or sell at the market that is to be executed only during the Nasdaq Closing Cross. MOC orders can be entered, cancelled, and corrected between 9:30:01 a.m. and 3:50:00 p.m. MOC orders can

be cancelled between 3:50:00 p.m. and 3:55:00 p.m. only by requesting Nasdaq to correct a legitimate error (e.g., side, size, symbol, price or duplication of an order). MOC orders cannot be cancelled after 3:55:00 p.m. for any reason. MOC orders will execute only at the price determined by the Nasdaq Closing Cross. All MOC orders must be available for automatic execution.

(5) No Change.

(6) No Change.

(b) No Change.

(c) No Change.

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

In its filing with the Commission, 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 IV 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 is proposing to amend NASD Rule 4709 governing the NASDAQ Closing Cross to provide that market participants would be able to cancel IO, MOC, or LOC orders between 3:50 p.m. EST and 3:55 p.m. only by requesting Nasdaq to correct a legitimate error, including side, size, symbol, price or duplication of an order. Market participants would not be permitted to cancel IO, MOC, or LOC orders after 3:55 p.m. for any reason.

Nasdaq believes that providing the ability to cancel orders that contain legitimate errors would protect the marketplace from the potential distortions that inadvertent errors might cause during the Nasdaq Closing Cross. Other markets permit similar types of corrections to take place in advance of the actual close. For example, the New York Stock Exchange provides similar protection for on close orders. NYSE Rule 123C provides that “[b]etween 3:40 p.m. and 3:50 p.m., MOC orders are irrevocable, except to correct a legitimate error (e.g., side, size, symbol, price or duplication of an order).”

Nasdaq Regulation staff in the TradeWatch section of MarketWatch (“MW”) would perform the correction of legitimate errors based upon members’ requests. The cancellation of IO, LOC, and MOC orders would be limited to circumstances where a firm could clearly demonstrate that it made a legitimate error. Because of the time constraints in operation at the end of the trading day, Nasdaq’s staff would not be able to engage in a review of whether an the order entry was in fact erroneous.

Accordingly, the criteria that Nasdaq would use to determine whether an entry is a legitimate error would include:

Size of Order: If an order were to be entered with the wrong size and such erroneous size was greater than 1000 shares and the mistake in size was greater than 20% from the correct size, MW would cancel the order. Orders entered not exceeding the threshold factors would not be corrected.

Price of Order: If a LOC were to be entered at a price different from that intended by 10% or more, MW would cancel the order. If error were to be less than 10%, or if an order were to be entered as an MOC instead of LOC, MW would not take action.

Symbol: If a market participant were able to show it made a mistake in entering an order in the wrong stock by identifying the symbol for which it meant to enter an order, MW would cancel the incorrect order. Nasdaq would not make an entry for the firm for the intended symbol.

Side of Order: If the order were to be entered as a buy (sell) order when it should have been a sell (buy) order, MW would cancel the order.

Duplication of Order: If a firm were to duplicate an order, MW would cancel the duplicate order.

In all of the above instances, time permitting, TradeWatch would use its best efforts to cancel MOC, LOC, or IO orders that contain a legitimate error. The firm making the error would be required to contact TradeWatch by telephone in a timely manner and, during that communication, would be required to provide all necessary details regarding the specific order(s) entered in error to be cancelled. Failure to provide the necessary details in a timely manner would result in no cancellation. The firm seeking cancellation of an order would be required to provide objective proof that a mistake was made. Submission by email or fax of an order ticket or other proof of the error would be required to be made as soon as practicable and no later than 5:00:00 p.m. on the day of the cancellation. Failure to provide satisfactory information regarding the basis of the error would be a per se violation of the rule.

Because of the impact on price formation in the closing seconds of the trading day that cancellations could cause, Nasdaq staff would not attempt to cancel any orders after 3:55:00 p.m. All efforts by Nasdaq to act on cancellation requests would be made on a best efforts basis and might not be successful prior to 3:55:00 p.m. For example, firms that enter orders for a basket of

stocks must understand that if the basket is large and involves a number of erroneous entries, Nasdaq may be unable to cancel all of the orders entered prior to 3:55:00 p.m.

2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 15A of the Act,³ in general, and with Section 15A(b)(6) of the Act,⁴ in particular, in that Section 15A(b)(6) requires the NASD's rules to be designed, among other things, to protect investors and the public interest. Nasdaq's believes that its current proposal is consistent with the NASD's obligations under these provisions of the Act because it would result in the public dissemination of information that more accurately reflects the trading in a particular security at the close. Furthermore, to the extent a security is a component of an index, Nasdaq believes the index would more accurately reflect the value of the market, or segment of the market, the index is designed to measure. Nasdaq believes the corresponding result should be trades, or other actions, executed at prices more reflective of the current market.

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.

³ 15 U.S.C. 78o-3.

⁴ 15 U.S.C. 78o-3(b)(6).

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- A. by order approve such proposed rule change, or
- B. institute proceedings to determine whether the proposed rule change should be disapproved.

IV. 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-2004-065 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-2004-065. 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-2004-065 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁵

Margaret H. McFarland
Deputy Secretary

⁵ 17 CFR 200.30-3(a)(12).