

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51233; File No. SR-NASD-2005-017)

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 thereto Regarding Modifications to the Nasdaq Opening Process For Nasdaq-Listed Stocks

February 18, 2005

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 January 25, 2005, 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. On February 15, 2005, Nasdaq amended the proposed rule change (“Amendment No. 1”).³ Nasdaq has designated the proposed rule change as “non-controversial” under Section 19(b)(3)(A) of the Act⁴ and Rule 19b-4(f)(6) thereunder,⁵ which renders the proposed rule change effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ In Amendment No. 1, Nasdaq restated the proposed rule change in its entirety.

⁴ 15 U.S.C. 78s(b)(3)(A).

⁵ 17 CFR 240.19b-4(f)(6).

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

Nasdaq is filing the proposed rule change, as amended, to extend a current pilot program until April 30, 2005, during which time Nasdaq will continue to reject the entry of Total Day Orders prior to 9:25 a.m. The pilot rule language under NASD Rule 4701(ss)(2) was established on November 3, 2004, and is effective through February 2, 2005.⁶ This proposal would extend the pilot language under Rule 4701(ss)(2) without change through April 30, 2005. Therefore, there is no proposed rule language contained in this proposal.

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, as amended, 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 extend through April 30, 2005, a pilot designed to address a harmful unintended consequence of the Modified Nasdaq Opening. Specifically, upon implementing the improved pre-opening trading environment set forth in Rule 4704(b), Nasdaq identified a harmful unintended consequence of the Modified Opening Process

⁶ See Securities Exchange Act Release No. 50640 (November 5, 2004), 69 FR 65664 (November 15, 2004) (SR-NASD-2004-172) ("Release No. 34-50640").

("MOP") by which Nasdaq establishes its opening order book and unlocks and uncrosses the market. As described in SR-NASD-2004-071, firms have three options for determining the price at which their carryover quotes are opened at 9:25: (1) the last quotation price entered during the previous day; (2) the last quotation price the firm enters after 7:30 and before 9:25 a.m.; or (3) the quote limits for Nasdaq, currently \$.01 (bid) and \$2,000 (ask).⁷ Many Nasdaq participants have programmed their quotation management systems to select the first option, carrying over the final quotation entered during the previous trading day. At the same time, a small number of firms have entered X Orders into Nasdaq's system that cross the market by a significant amount, in some cases by as much as 20 dollars. When Nasdaq applies the MOP, which automatically executes orders that would cross the market, the system executes those X Orders that are significantly away from the market against the stale carryover quotations of other members resulting in inferior executions.

To address this situation quickly, Nasdaq changed the pre-opening trading environment for a pilot period ending February 2, 2005.⁸ Specifically, Nasdaq moved the beginning entry time for X Orders from 7:30 a.m. to 9:25 a.m. As a result, X Orders do not participate in the market opening process described in Rule 4704(b), which begins at 9:25 a.m., eliminating the risk of X Orders automatically executing against a stale quote during that process. Nasdaq believes that that change was necessary and sufficient to address quickly the harmful unintended consequence described above and to preserve a

⁷ See Securities Exchange Act Release No. 50405 (September 16, 2004), 69 FR 57118 (September 23, 2004) (SR-NASD-2004-071).

⁸ See Release No. 34-50640, supra note 6.

fair and orderly opening of trading in Nadsaq. It is important to note that participation in pre-opening trading is completely voluntary on firms' part, that the actual opening of the market and concomitant market maker obligations would continue to begin at 9:30 a.m. as is the case today.

Nasdaq proposes to extend the pilot through April 30, 2005, while the Commission considers Nasdaq's proposed permanent solution to this issue. On January 25, 2005, Nasdaq filed a proposal to make three changes to the opening process: (1) applying the Market Opening Process at 8:00 a.m. rather than 9:25 as currently approved; (2) extending the availability of Total Day and Total Immediate or Cancel Orders to 8:00 a.m. from 9:25, and adding the availability of Total Good-till-Canceled Orders during the same period; and (3) establishing a system default that protects market participants from unexpected executions upon the opening of Nasdaq's execution functionality at 8:00 a.m.⁹ According to Nasdaq, these modifications would provide a more efficient long-term solution, but they would take longer to implement than simply rejecting X Orders until 9:25. Nasdaq believes it is imperative to address the situation quickly and to simultaneously pursue a long-term solution.

2. Statutory Basis

Nasdaq believes that the proposed rule change, as amended, is consistent with the provisions of Section 15A of the Act,¹⁰ in general, and with Section 15A(b)(6) of the Act,¹¹ in particular, in that Section 15A(b)(6) requires, among other things, that a national

⁹ See SR-NASD-2005-009.

¹⁰ 15 U.S.C. 78o-3.

¹¹ 15 U.S.C. 78o-3(b)(6).

securities association's rules be designed to protect investors and the public interest. Nasdaq believes that its current proposal is consistent with the NASD's obligations under these provisions of the Act because it would result in a more orderly opening for all Nasdaq stocks. The proposed rule change, as amended, would create a fair, orderly, and unified opening for Nasdaq stocks, prevent the occurrence of locked and crossed markets in halted securities, and preserve price discovery and transparency that is vital to an effective opening of trading.

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

Nasdaq does not believe that the proposed rule change, as amended, would 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

Nasdaq neither solicited nor received written comments with respect to the proposed rule change, as amended.

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

Because the foregoing proposed rule change, as amended, does not:

(i) significantly affect the protection of investors or the public interest;

(ii) impose any significant burden on competition; and

(iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, if consistent with the protection of investors and the public interest, it has become effective pursuant to Section 19(b)(3)(A)

of the Act¹² and Rule 19b-4(f)(6) thereunder.¹³ Nasdaq has requested that the Commission waive the five-day pre-filing notice requirement and the 30-day operative delay for “non-controversial” proposals, based upon a representation that the proposal is of the utmost importance to the fair and orderly operation of The Nasdaq Stock Market during the pre-opening trading period. The Commission believes that waiver of the five-day pre-filing requirement and the 30-day operative delay is consistent with the protection of investors and the public interest because it will allow Nasdaq to continue the pilot without interruption. For this reason, the Commission designates the proposal to be effective and operative upon filing with the Commission.¹⁴

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

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

¹² 15 U.S.C. 78s(b)(3)(A).

¹³ 17 CFR 240.19b-4(f)(6).

¹⁴ For purposes only of waiving the 30-day operative delay of the proposed rule change, the Commission considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

(<http://www.sec.gov/rules/sro.shtml>); or

- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASD-2005-017 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-2005-017. 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 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-2005-017 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.¹⁵

Margaret H. McFarland
Deputy Secretary

¹⁵ 17 CFR 200.30-3(a)(12).