

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52276; File No. SR-NASD-2004-131)

August 17, 2005

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Granting Approval to Proposed Rule Change and Amendments Nos. 1 and 2 Thereto, and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 3 Thereto, Relating to the Listing and Trading of Leveraged Index Return Notes Linked to the Nikkei 225 Index

I. Introduction

On August 30, 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 list and trade Leveraged Index Return Notes Linked to the Nikkei 225 Index (“Notes”) issued by Merrill Lynch & Co., Inc. (“Merrill Lynch”). On March 21, 2005, Nasdaq filed Amendment No. 1 to the proposed rule change and on March 31, 2005, Nasdaq filed Amendment No. 2 to the proposed rule change. The proposed rule change and Amendments Nos. 1 and 2 were published for comment in the Federal Register on July 12, 2005.³

The Commission received no comments on the proposal. This order approves the proposed rule change, as amended by Amendments Nos. 1 and 2. Simultaneously, the Commission provides notice of filing of Amendment No. 3 to the proposed rule change and grants accelerated approval of Amendment No. 3.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 51970 (July 5, 2005), 70 FR 40091 (July 12, 2005).

The Commission has previously approved the listing of securities, the performance of which has been linked, in whole or in part, to the Nikkei 225 Index (the “Index”). The Notes, which are a series of non-convertible debt securities, will not be secured by collateral, will not pay interest and are not subject to redemption by Merrill Lynch or at the option of any beneficial owner before their maturity term of 4 ½ years. At maturity, if the value of the Index has increased, a beneficial owner of a Note would be entitled to receive the original offering price (\$10), plus an amount calculated by multiplying the original offering price (\$10) by an amount equal to 123% (“Participation Rate”) of the percentage increase in the Index. If, at maturity, the value of the Index has not changed or has decreased by up to 20%, a beneficial owner of a Note would be entitled to receive the full original offering price. However, 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 by more than 20%, a beneficial owner would receive less, and possibly significantly less, than the original offering price: for each 1% decline in the Index below 20%, the redemption amount of the Note would be reduced by 1.25% of the original offering price.

The Index, which is a modified, price-weighted index, is composed of 225 securities and is broad-based. As of July 8, 2005, the highest weighted stock in the Index had the weight of 2.9705%, and the top five stocks had the cumulative weight of approximately 13.2606%. In addition, as of July 8, 2005, the Index had an average daily trading volume for an average Index component of 3,228,120 shares. As of the same date, the market capitalization of the Index components ranged from approximately 13.04

trillion yen to 40 billion yen, which corresponded approximately to 116 billion U.S. dollars and 353 million U.S. dollars.

II. Discussion and Commission Findings

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 since the Notes will be deemed equity securities for the purposes of NASD Rule 4420(f), the NASD and Nasdaq existing equity trading rules would apply to the Notes. The Commission also notes that pursuant to Rule 2310(a) 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. Also, pursuant to 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 investments objectives, and (4) such other information used or considered to be reasonable by such member in making recommendations to the customer. Members are also reminded that the Notes are considered non-conventional investments for purposes of the NASD Notice to Members 03-71 (Nov. 2003). In addition, Nasdaq will distribute a circular to members that provides guidance regarding compliance responsibilities and requirements, including suitability recommendations, and highlights the special risks and characteristics of the Notes. Furthermore, the Notes will be subject to the equity margin rules and the regular equity trading hours of 9:30 a.m. to 4:00 p.m. will apply to transactions in the Notes.

Nasdaq represents that the NASD's surveillance procedures are adequate to properly monitor the trading of the Notes. Specifically, the NASD will rely on its current surveillance procedures governing equity securities and will include additional monitoring on key pricing dates. Finally, Nasdaq will commence delisting or removal proceedings with respect to the Notes (unless the Commission has approved the continued trading of the Notes) if specified standards with respect to the Notes are not continuously maintained.

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. The Commission finds that the proposed rule change is consistent with the provisions of Section 15A of the Act,⁴ in general, and with Section 15A(b)(6) of the Act,⁵ in particular, in that it 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 should provide investors with another investment vehicle based on the Index and a means of participating in the market for foreign securities. The Commission believes that the Notes will permit investors to obtain returns based on the Nikkei while at the same time limiting the downside risk of the original investment as a result of the 20% threshold. As described more fully above, even if the value of the

⁴ 15 U.S.C. 78o-3.

⁵ 15 U.S.C. 78o-3(b)(6).

Index decreases more than 20%, in no event will the decline in the value of the Notes equal (unless the Index value drops to zero) or exceed the decline in the value of the Index.

The Commission finds good cause for approving Amendment No. 3 before the 30th day after the date of publication of notice of filing thereof in the Federal Register. Nasdaq filed Amendment No. 3 solely for purposes of updating figures related to the Index. Because the updated figures are non-controversial and do not raise any concerns about the nature of the Index or the Notes, the Commission finds good cause for accelerating approval of Amendment No. 3 in order to prevent unnecessary delay in the approval of this proposed rule change in its entirety.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Amendment No. 3 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-2004-131 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-NASD-2004-131. 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-2004-131 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁶ that the proposed rule change (SR-NASD-2004-131), as amended by Amendments Nos. 1 and 2, be, and it hereby is, approved, and that Amendment No. 3 to the proposed rule change be, and thereby is, approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁷

Margaret H. McFarland
Deputy Secretary

⁶ 15 U.S.C. 78s(b)(2).

⁷ 17 CFR 200.30-3(a)(12).