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Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street NW
Washington, DC 20549-0609

Re: **File No. SR-NASD-2003-173 (Notice of Filing of Proposed Rule Change Regarding the Establishment of a Nasdaq Closing Cross)**

Dear Mr. Katz:

The American Stock Exchange LLC ("Amex") respectfully submits the following comments with respect to the above referenced notice of rule filing (the "Notice") by The Nasdaq Stock Market, Inc. ("Nasdaq"), which would establish a Nasdaq Closing Cross (the "Closing Cross") applicable to certain, and potentially all, Nasdaq securities. Although we commend Nasdaq for finally undertaking to improve its closing process which has been the subject of industry concerns for years, we believe that the proposed procedures for the Closing Cross would perpetuate some of the same serious flaws that characterize the existing Nasdaq closing process.

1. Under Certain Circumstances, the Nasdaq Methodology is Inherently Subjective and May Grant Excessive Discretion to Nasdaq Officials

The procedures outlined in the Notice endow unidentified "Nasdaq officials" with a potentially unacceptable degree of discretion in the determination of the Closing Cross price ("Crossing Price"). Certain of the procedures, as described, fail to provide a clear understanding of what the pricing outcome would be for a given set of market data. For example, Nasdaq proposes the establishment of a "circuit breaker" for the Closing Cross in the event that the calculated Crossing Price lies outside a preset boundary defined by two benchmarks by a specified amount ("Threshold Percentage"). In such an event, the Notice states that, "Nasdaq would change the Nasdaq Crossing Price such that it would be within the threshold percentage. The Threshold Percentage would be set by Nasdaq officials and would vary based on market conditions and experience with the close." Such a highly subjective adjustment process provides no rational way to predict the pricing outcome or to determine the likelihood of getting a Market on Close order executed. The Amex believes that Nasdaq should provide a description of the specific, objective methodology that it will use to determine the value of the Threshold Percentage, including the circumstances under which the methodology would be applied to obtain a new value for that parameter and how frequently the value would be expected to change.

Based on the description in the Notice, "Nasdaq officials" could change the Threshold Percentage without limitation with regard to order of magnitude (e.g., 50%) or frequency (e.g., daily) if they so chose. It is also not clear how far in advance such Threshold Percentage would be published, and whether it could be changed just prior to the Nasdaq close. In addition, Nasdaq has provided no information concerning the qualifications of its officials who will make these decisions.

2. <u>The Price Determined in the Closing Cross May Not Reflect True Market Forces</u>

The Amex is also concerned that, in its process of adjusting the Crossing Price to be within the Threshold Percentage, Nasdaq may set a Crossing Price that does not reflect true market forces. A large part of the challenge of any closing process has to do with how to offset order imbalances. Order imbalances, simply put, reflect excess supply or demand, which affects market movement. Nasdaq's threshold process supposes that "Nasdaq officials" will determine acceptable levels of market movement, not the market itself.

In addition, Nasdaq should specify the time period within which such an adjustment to the calculated Crossing Price will occur and clarify what the post-adjustment consequences will be for those participants in the initial Crossing Price determination. Specifically, will participants in the initial determination with limit orders that are no longer executable at the adjusted Crossing Price be informed that they are now being excluded from the Closing Cross, and in what time frame will this occur? Similarly, will additional participants be included whose orders were excluded from the initial Crossing Price determination but now fall within the parameters of the adjusted Crossing Price? When will those participants be informed of their order executions? Finally, does the possibility exist that a large adjustment to bring the Crossing Price within the calculated Threshold Percentage could result in no trades taking place at the adjusted value as a result of no executable orders on one side of the market?

Our concern is that a market mechanism that allows the entry of MOC orders, but does not guarantee the execution of those orders, at once compels traders to enter orders into this system (to the exclusion of other venues) while at the same time not ensuring the execution of a market order.

Even with respect to the less subjective portions of the above referenced "circuit breaker" procedures, there are a number of issues that the Amex believes need to be addressed in the rule filing. For example, with respect to the above referenced benchmarks, Nasdaq stated in the Notice that, "Nasdaq has selected two benchmark values representing market conditions approximately five seconds prior to the close: (1) The Volume Weighted Average Nasdaq Inside ("VWAI") over the period from 3:59:54 to 3:59:57; and (2) the Volume Weighted Average Price ("VWAP") based upon SuperMontage executions over a period from 3:59:55 to 4:00:00." The Amex wonders why there is a difference in the time interval over which the VWAI (3 seconds) and VWAP (5 seconds) are measured, and why both times do not coincide. In addition, with respect to Nasdaq's adjustment of the Crossing Price "such that it would be within the threshold percentage," Nasdaq needs to clarify whether this means an adjusted price that is within the Threshold Percentage of both the VWAI and the VWAP, or of only one of them. If the latter, under what circumstances would one benchmark be used over the other?

Nasdaq also states in the Notice that "Unexecuted MOC, LOC, and IO orders will be canceled." The Amex believes that Nasdaq should clarify the circumstances under which there will be unexecuted MOC orders. Under the Amex's closing procedures such MOC orders are guaranteed an execution, and we are puzzled that that would not necessarily be the case under the Closing Cross. In addition, Nasdaq should specify whether it will or will not disseminate a Nasdaq Official Closing Price ("NOCP") if no Crossing Price exists.

3. The Determination of the Closing Cross Price is Vulnerable to Manipulation in the Closing Seconds from "Spraying" Activity

The Amex is further concerned that the VWAI and VWAP benchmarks, as well as "the distance from the 4:00:00 SuperMontage bid-ask midpoint" that Nasdaq has proposed as one of the criteria to be utilized in setting the Crossing Price, are easily subject to market manipulation in the closing seconds of trading. In its letter to Secretary Katz dated November 17, 2003 (the "Comment Letter") responding to Nasdaq's comment letter on Amex rule filing SR-Amex-2003-81, the Amex described and gave specific examples of the practice of "spraying" the open and close that has been a problem on Nasdaq for years.[1] This practice, which is easier to accomplish on an automated trading facility, involves the entering of a barrage of small orders (e.g., 100 shares) into SuperMontage by a market participant for the purpose of influencing the closing price of a stock on Nasdaq. Such activity can be used to produce a profit on a much larger number of shares, to the detriment of other market participants. We reiterate our concern expressed in the Comment Letter that, to our knowledge, Nasdaq has taken no enforcement action to address this type of manipulative activity and the resultant excessive volatility in the closing seconds of the trading day. Consequently, the methodology proposed for the Closing Cross is flawed by virtue of the fact that it would perpetuate the existing vulnerabilities to "spraying" at the close.

4. The Determination of the Crossing Price Could be Subject to Improper Influence by Large Broker Dealers

In addition to the problems described above, the Amex is also concerned that the Closing Cross could be subject to manipulation in other ways by insiders. Having the Crossing Price determined at the discretion of Nasdaq officials and not by the market itself could raise serious doubts regarding the integrity of the process that determines the value of billions of dollars of

[1] Comment Letter at Page 4, citing the Nasdaq close for Biogen on November 12, 2003 as an example of "spraying" the close. See also related Attachment A to the Comment Letter illustrating how 73 100-share orders in the five second period prior to the close resulted in a substantial move in the closing bid-ask for Biogen. The Amex has other examples of such activity just as or more egregious. In Amex's view, both the VWAI and VWAP benchmarks could be easily manipulated in the three- and five-second time frames provided, respectively.

mutual funds and index funds each day. This practice would effectively maintain the status quo with respect to the current process for "normalization" of the NOCP, whereby the interests of a few powerful broker dealers who guarantee the closing price to their customers may be accommodated to the detriment of other investors. The Amex is further concerned that the unidentified "Nasdaq officials" who would be exercising their discretion in setting the Crossing Price under the "circuit breaker" procedures would not be subject to the same rules and restrictions as specialists and market makers. We reiterate that Nasdaq has provided no information concerning the qualifications of its officials who will make these decisions.

To deal with certain of the problems described in the immediately preceding paragraph, the Amex believes that explicit guidelines must be established regarding verbal communication between Nasdaq and its member firms during the Closing Cross whenever circumstances require the exercise of discretion by Nasdaq officials in the determination of the Crossing Price. At a minimum, there should be a "Chinese wall" prohibition against Nasdaq member firms communicating with Nasdaq employees in an attempt to influence the outcome of the pricing process.

Finally, footnote 6 to the Notice states that "Nasdaq would also be able to also employ the Benchmark Values and Threshold Percentages for determining the Nasdaq Official Closing Price for stocks that are not included in the Nasdaq Closing Cross."[2] The Amex believes that Nasdaq should clarify its intentions with regard to the broader use of its proposed methodology that is hinted at in this footnote, and the timing thereof. Certainly the footnote suggests that the impact of the proposed procedures could go beyond Nasdaq's initial statement in Item I of the Notice that the proposed rule change "would establish the Nasdaq Closing Cross for certain Nasdaq National Market securities." Such potential wider impact makes it even more imperative that Nasdaq address the weaknesses in its proposed rule change that we have described herein. Nasdaq should also clarify whether this potential change in its methodology for determining the NOCP will require amendment of its related rule establishing the NOCP that was approved by the Securities and Exchange Commission in 2003.[3]

Conclusion

After careful review of Nasdaq's proposed rule change that would establish the Closing Cross, the Amex believes that the basic pricing process as outlined in the Notice is flawed because of the inherent subjectivity of the methodology when the discretion of Nasdaq officials is brought into play. The procedures need to be made more precise and objective so that the price determination can be readily understood by outside parties to the extent that such parties would be able to duplicate the Crossing Price calculation based on a given set of closing data and their knowledge of the procedures.

The Amex also is expressing its concern that Nasdaq's proposed Closing Cross methodology would perpetuate several of the serious problems with its current market closing

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[2] Exchange Act Release No. 48878 (December 4, 2003), 68 Fed. Reg. 69101 (December 11, 2003).
[3] Exchange Act Release No. 47517 (March 18, 2003), 68 Fed. Reg. 14446 (March 25, 2003).

procedures and prices. These include (1) the fact that a Crossing Price could be selected in a manner that does not reflect true market forces, (2) the potential for manipulation of the Crossing Price determination through "spraying" of small orders at the close (which we illustrated graphically in the Comment Letter) and (3) the potential for the Crossing Price determination to be influenced by certain Nasdaq member firms who may intervene for their own interests. We have also raised a number of other questions and matters needing clarification.

We appreciate the opportunity to comment on the Nasdaq rule filing and would be pleased to provide further information regarding our views if requested.

Sincerely,

Michael J. Ryan, Jr

Michael Ryan

cc: The Hon. William Donaldson, Chairman
The Hon. Cynthia Glassman, Commissioner
The Hon. Paul Atkins, Commissioner
The Hon. Roel Campos, Commissioner
The Hon.. Harvey Goldschmid, Commissioner
Giovanni Prezioso, General Counsel
Annette Nazareth, Director, Division of Market Regulation
Robert Colby, Deputy Director, Division of Market Regulation
Katherine England, Assistant Director, Office of Market Supervision
Lawrence Harris, Chief Economist
Edward Knight, Executive Vice President, Nasdaq