January 13, 2003.[17] Nasdaq participants will then have up to 90 calendar days to transition from the NBBO-based bid tick to the Nasdaq-based bid tick for trades executed outside Nasdaq execution systems and reported to Nasdaq. In the event that Nasdaq is unable to display the Nasdaq-based bid tick indicator at that time, Nasdaq will inform the Commission and delay implementation of this transition period. In addition, Nasdaq is working with the NASD to ensure a continued high level of short sale compliance during that transition period.

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

Nasdaq believes that the proposed rule change will not 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

Comments were neither solicited nor received.

III. 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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street NW., Washington, DC 20549–0609. 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 will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to the file number in the caption above and should be submitted by January 14, 2003.

IV. Commission's Findings and Order Granting Accelerated Approval of the Amendment

After careful consideration, the Commission finds, for the reasons set forth below, that the extension of the Short Sale Rule Pilot until June 15, 2003, the suspension of the existing PMM standards until June 15, 2003 and the modification of the method used to calculate the bid tick indicator used by members to determine the permissibility of a short sale are consistent with the requirements of the Act and the rules and regulations thereunder. In particular, the proposal is consistent with Section 15A(b)(6)[18] of the Act, which requires that the NASD's rules be designed, among other things, to remove impediments to and perfect the mechanism of a free and open market and a national market system and to promote just and equitable principles of trade.

The Commission finds that the continuation of the Short Sale Rule Pilot, the continued suspension of the PMM standards, and the modification of the method used to calculate the bid tick indicator will maintain the status quo while the Commission is considering amending Rule 10a–1 under the Act. This extension of the pilot, continued suspension of the PMM standards, and modification of the bid tick test is subject to modification or revocation should the Commission amend Rule 10a–1 under the Act in a manner as to deem the extension, suspension, or modification unnecessary or in conflict with any adopted amendments.[19]

The Commission finds good cause for approving the extension of the Short Sale Rule Pilot, the suspension of existing PMM standards, and the modification of the method used to calculate the bid tick indicator prior to the 30th day after the date of publication of notice of the filing in the **Federal Register**. It could disrupt the Nasdaq market and confuse market participants to reintroduce the previous PMM standards while new PMM standards are being developed and while the Commission considers amending Rule 10a–1 under the Act.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[20] that Amendment No. 13 to the proposed rule change, SR–NASD–98–26, which extends the NASD Short Sale Rule Pilot through June 15, 2003, suspends the PMM standards through June 15, 2003, and modifies the method used to calculate the bid tick indicator is approved on an accelerated basis.[21]

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[22]

Margaret H. McFarland,

Deputy Secretary.

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[17] At that time, Nasdaq anticipates that the quotations of exchanges that lack a hard-wired linkage to Nasdaq will be removed from the Nasdaq Quotation Data Service (''NQDS'') data feed. Nasdaq is currently analyzing alternative methods for calculating the Nasdaq-based bid tick indicator in the event the removal from NQDS of quotations of exchanges that lack hard-wired linkages is delayed.

[18] 15 U.S.C. 78*o*–3(b)(6).

[19] Absent an exemption, Rule 10a–1 under the Act would apply to Nasdaq on Commission approval of its exchange registration.

[20] 15 U.S.C. 78s(b)(2).

[21] In approving Amendment No. 13, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[22] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–47003; File No. SR–NASD–2002–59]

Self-Regulatory Organizations; Order Approving a Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to a New Trade Report Modifier To Be Attached to Trades Whose Prices Exceed Certain Parameters

December 16, 2002.

I. Introduction

On April 29, 2002, 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 create a new trade report modifier to be attached to trades whose prices exceed certain parameters. The proposed rule change was published for comment in the **Federal Register** on June 14, 2002.[3] The Commission received two comment letters regarding the proposal.[4] Nasdaq responded to the commenters on November 30, 2002.[5]

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 46056 (June 10, 2002), 67 FR 40975.

[4] *See* letter from Michael T. Dorsey, Senior Vice President, Director of Legislative and Regulatory Affairs, Knight Trading Group, to Commission, dated July 19, 2002 (''Knight Letter'') and letter from Cindy D. Foster, Vice President, Compliance, SunGard Trading Systems, to Jonathan G. Katz, Secretary, Commission, dated July 5, 2002 (''SunGard Letter'').

[5] *See* letter from Edward S. Knight, Executive Vice President, General Counsel, Nasdaq, to Jonathan G. Katz, Secretary, Commission, dated November 20, 2002 (responding to the comment letters received regarding the proposed rule change) (''Nasdaq Response Letter'').

This order approves the proposed rule change.

II. Background

Trades reported to Nasdaq using the Automated Confirmation Transaction (''ACT'') Service are subject to procedures that identify trades executed at prices away from the current market. This process helps to ensure a fair and orderly market by preventing such trades from being disseminated to the public as last sale reports and/or by detecting trades that are reported at erroneous prices.

The process differs slightly depending on whether a trade is executed using a Nasdaq system, which then automatically reports the trade to ACT (*e.g.*, SelectNet), or the trade is submitted to ACT directly by a member. ACT rejects a trade that is submitted directly by a member if the price reported is outside established parameters. The member has an opportunity to resubmit the trade, which then will be subject to a different set of parameters. If the price is rejected after this second process, the member must call Nasdaq's MarketWatch Department to explain why the execution price was so far away from the current market. If the MarketWatch staff determines, on the basis of its conversation with the member, that there is an adequate rationale for such price, the staff would submit the trade to ACT.[6] In such circumstances, the trade is normally being reported more than 90 seconds after the trade was executed, and so the MarketWatch staff would report the trade with the .SLD modifier attached, which indicates a late trade report.[7] Trades reported with a .SLD modifier are not included in the last sale calculation, but are included in the calculation of the high and low price for the security.

Trades executed using Nasdaq systems, however, are subject to a different process due to the manner in which such trades are transmitted to ACT. The information passed to ACT from a Nasdaq system does not include the exact location, or terminal, within a member from which an order/execution emanates. Therefore, such trades are not subject to the second validation process which allows members to resubmit a trade report after it is rejected initially, since the exact location within a member to which a reject message can be sent is unknown. To compensate for this difference and to prevent such trades from being included in the last sale calculation, Nasdaq automatically attaches the .SLD modifier to any trades executed using a Nasdaq system whose prices exceed the initial parameters. Nasdaq also includes another modifier with these trade reports to indicate that the .SLD modifier has been attached by a Nasdaq system. This other modifier ensures that members would not be cited for late trade reporting on the basis of these trades.

Nasdaq believes that the process described above has worked well in promoting a fair and orderly market because it has prevented certain anomalous prices from being included in the last sale calculation, which is used for many purposes including as a measure of the current market for a security; a determinant of the execution price of certain types of orders (*e.g.*, market on close orders); and in determining index values. Nasdaq believes this process has helped provide more accurate information about the prices at which individual securities are trading, and for that matter, the market, or a segment of the market, if such securities are components of indices designed to measure the entire market or a particular segment.

III. Description of the Proposed Rule Change

Under the proposed rule change, Nasdaq has identified a means of further improving the current process. Presently, the .SLD modifier prevents a trade report from being included in the last sale calculation, but it does not prevent such a report from being included in the calculation of the high and low price of a security. As such, a trade that has been excluded from the last sale calculation because its price exceeds the parameters, nevertheless, may set the high or low price for a security. Nasdaq believes that these trades should not establish the high or low price for a security because the high and low prices are also used as a measure of a security's performance, or could trigger certain actions.

Therefore, Nasdaq proposed to create a new modifier that would exclude such trades from the high/low calculations, as well as the last sale calculation.[8] This new modifier tentatively would be known as the ''Out of Range,'' or .OR , modifier and would be used instead of the .SLD modifier in the circumstances described above. Under the proposed rule change, members would not have the ability to append this modifier to trade reports. Nasdaq proposed that only Nasdaq staff and Nasdaq systems would append this modifier, and only for transactions in Nasdaq National Market System, SmallCap Market, and OTC Bulletin Board securities. For example, if a trade executed using SelectNet exceeds the price parameters, ACT automatically would append the .OR modifier to the trade report instead of the .SLD modifier. Similarly, the Nasdaq MarketWatch staff would append the .OR modifier to reports they submit. Nasdaq believes that the number of trade reports that contain the .SLD modifier either attached by ACT or the Nasdaq MarketWatch staff because the price is outside the parameters is very small.[9] Nasdaq believes that the current proposal to create a new modifier would not affect this number since all that is being changed is the modifier that is being attached, and Nasdaq is not proposing to modify the price parameters.

Nasdaq recognized that, in certain circumstances, members may believe that they have executed a trade at a price that provides valuable information to the market, even though the price is outside the parameters. To ensure that such trades are not inappropriately withheld from the last sale and high/low calculations, members would be able to contact the Nasdaq MarketWatch staff to request that the .OR modifier be removed from the trade report. The member must explain the facts and circumstances surrounding the trade and why the price was reasonable, as measured against the market at the time of execution. If the MarketWatch staff agrees with the explanation, it can remove the .OR modifier from the trade report.

The process for developing and implementing the modifier, which will include testing with market data vendors, will take several months. Nasdaq would continue to utilize the .SLD modifier in the manner described until the new modifier can be implemented.

[6] If the MarketWatch staff believes the price would be misleading to the market, the trade report would be submitted for clearing purposes only. Nasdaq believes that the number of instances in which the staff submits the report only for clearing purposes is very limited. The staff estimates that this occurs less than 10 times a year. In addition, the staff can refer the transaction to NASD Regulation for further investigation.

[7] NASD rules require that trades be marked late, using the .SLD modifier, if they are reported more than 90 seconds after execution. *See e.g.,* NASD Rule 4632.

[8] Nasdaq recognizes that trades whose prices exceed the price parameters nevertheless may be valid transactions that the parties want to settle. As such, these trades are transmitted to The Depository Trust and Clearing Corporation for clearing and settlement.

[9] Nasdaq estimates that, on a daily average, less than .002% of trades executed on Nasdaq are reported with the .SLD modifier due to the trade being executed at a price that exceeds the price parameters.

IV. Summary of Comments and Nasdaq's Response

As noted above, the Commission received two comment letters regarding the proposal.[10] Nasdaq filed a response letter to address concerns raised by the commenters.[11]

One commenter commended Nasdaq for its proposal as promoting a fair and orderly market for Nasdaq stocks through improved transparency.[12] This commenter supported the new modifier as a better indication of the trading activity then occurring in the marketplace. This commenter also suggested that Nasdaq create additional modifiers to address other unique execution scenarios, such as ''market on close'' orders. Nasdaq has indicated that it is presently examining several additional modifiers to address some of this commenter's concerns.[13]

The other commenter supported Nasdaq's proposal, but believed that the proposal should not be approved absent providing the same relief to members effecting transactions and transaction reports outside Nasdaq systems who experience similar problems with rejected trades.[14] This commenter believed that the process of having a member telephone Nasdaq MarketWatch, after ACT has rejected a trade for the second time, in order to enter the transaction and then append the .SLD, delays a trader's operations and could harm the execution of pending customer orders, especially in today's highly automated marketplace.

This commenter offered two methods that it believed would result in better use of member, market, and regulatory resources and further prevent any degrading of the execution of customer orders. First, the commenter suggested that Nasdaq adopt a new modifier that would be appended to transaction reports that followed the second rejection of ACT. Under this method, Nasdaq and NASD surveillance could then monitor the proper use of such modifier and, on a post-report review process during the day, contact members about those transactions that appear problematic. Alternatively, this commenter suggested that Nasdaq systems be programmed to automatically append a .SLD modifier and a .OR as it would with transactions executed and reported by Nasdaq systems. Transaction reports which evidence a delay between the execution and transaction report or a delay of the re-submission could still be rejected, and Nasdaq could then review these transactions on post-review basis.

In response, Nasdaq stated that its proposal complies with Section 15A(b)(6) of the Act[15] to protect investors and the public interest because it would result in the public dissemination of information that reflects more accurately the current trading in a particular security.[16] Furthermore, to the extent a security is a component of an index, the index would reflect more accurately the value of the market, or segment of market the index is designed to measure. Nasdaq also stated that this commenter offered no statutory analysis that would contradict Nasdaq's compliance with the Act and support the commenter's request to delay approval of the proposed rule change.

Furthermore, with respect to the commenter's suggestions, Nasdaq does not believe that it would be feasible to permit members to use the .OR modifier. Under the proposal, trades reported with a .OR modifier would not be included in the calculation of last sale, high price and low price of the security. Nasdaq notes that these calculations provide investors and market participants with important information about the prices at which a security is trading, and generally promote transparency and accurate price discovery. Therefore, Nasdaq believes that this ability to append the .OR modifier and thus prevent it from being included in these calculations must be strictly controlled. If members were permitted to append the .OR modifier, Nasdaq notes that the potential for mistake or purposely misusing the .OR modifier to withhold certain trade prices would have to be considered. Moreover, there is presently no automated, real-time means to surveil members for the proper use of the .OR modifier. Nasdaq believes this surveillance would be necessary to ensure that mistakenly marked trades are identified and then publicly disseminated at, or near, the time of the trade, which is when the information is useful. This risk of error, misuse, and surveillance complications also would limit the usefulness of any other modifier Nasdaq would create for use by members that would operate in the same manner as the .OR modifier.

Finally, Nasdaq states that it recognizes the challenges faced by members reporting trades in a fast-moving market and would continue to examine how it can address some of the concerns raised by this commenter. However, Nasdaq believes that the proposed solution should not create additional surveillance burdens for members and Nasdaq that outweigh the benefits of the proposal, or worse, that the benefits are exceeded by the potential for new areas of abuse. Nasdaq believes that developing a solution that strikes a balance among these factors is a lengthy process, and that delaying approval of its current proposal until a broader solution can be implemented would unnecessarily delay the benefits the .OR modifier currently can provide to investors and market participants.

V. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.[17] In particular, the Commission finds that the proposal is consistent with Section 15A(b)(6) of the Act,[18] in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

Specifically, the Commission finds that Nasdaq's proposal appears to be a reasonable effort to improve the information disseminated to investors. The Commission believes that the proposed modifier may be a practical method in identifying with specificity trades that fail price validation and may prevent these trades from impacting the last sale calculation and the high and low price for the security. The Commission also believes that the corresponding result of the proposal may be trades, or other actions, executed at prices more reflective of the current market when the price of an execution, or other action, is based on the last sale, the high price or low price of a security, or the value of an index. Furthermore, the Commission believes that the proposal and Nasdaq's Response Letter appears to reasonably address the concerns raised by the commenters. Nasdaq has noted that it

[10] *See* Knight Letter and SunGard Letter, *supra* note 4.

[11] *See* Nasdaq Response Letter, *supra* note 5.

[12] *See* Knight Letter, *supra* note 4.

[13] *See* Nasdaq Response Letter, *supra* note 5.

[14] *See* SunGard Letter, *supra* note 4.

[15] 15 U.S.C. 78*o*–3(b)(6).

[16] *See* Nasdaq Response Letter, *supra* notes.

[17] In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[18] 15 U.S.C. 78*o*–3(b)(6).

would continue examining several additional modifiers and solutions to address other unique scenarios, such as ''market on close'' orders, and issues raised by the commenters.[19]

VI. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with the requirements of the Act and rules and regulations thereunder.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[20] that the proposed rule change (SR–NASD–2002–59) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[21]

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–47009; File No. SR–NASD–2002–175]

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change and Amendment No. 1 Thereto by the National Association of Securities Dealers, Inc. Relating to the Listing and Trading of Market Recovery Notes Linked to the Nasdaq-100 Index

December 16, 2002.

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 December 10, 2002, the National Association of Securities Dealers, Inc. (''NASD'' or ''Association''), through its subsidiary, The Nasdaq Stock Market, Inc. (''Nasdaq''), filed with the Securities and Exchange Commission (''Commission'' or ''SEC'') the proposed rule change as described in Items I, and II, below, which Items have been prepared by Nasdaq. On December 13, 2002, the NASD filed Amendment No. 1 to the proposed rule change.[3] The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons and is approving the proposal, as amended, on an accelerated basis.

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

Nasdaq proposes to list and trade Market Recovery Notes Linked to the Nasdaq-100 Index (the ''Notes'') issued by Merrill Lynch & Co., Inc. (''Merrill Lynch'').

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 III 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

Under NASD Rule 4420(f), the Nasdaq may approve for listing and trading innovative securities which cannot be readily categorized under traditional listing guidelines.[4] Nasdaq proposes to list for trading the Notes, as described below, under NASD Rule 4420(f).

Description of the Notes

The Notes are a series of senior non-convertible debt securities that will be issued by Merrill Lynch and will not be secured by collateral. The Notes will have a term of not less than two and not more than four years. The Notes will be issued in denominations of whole units (''Unit''), with each Unit representing a single Note. The original public offering price will be $10 per Unit. The Notes will not pay interest and are not subject to redemption by Merrill Lynch or at the option of any beneficial owner before maturity in 2005.[5]

At maturity, if the value of the Nasdaq-100 Index[6] has increased, a beneficial owner will be entitled to receive a payment on the Notes based on triple the amount of that percentage increase, not to exceed a maximum payment per Unit (the ''Capped Value'') that is expected to be between $11 and $16.[7] Thus, the Notes provide investors the opportunity to obtain leveraged returns based on the Nasdaq-100 Index.

[19] *See* Nasdaq Response Letter, *supra* notes.

[20] 15 U.S.C. 78s(b)(2).

[21] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* letter John D. Nachmann, Senior Attorney, Nasdaq to Kathleen A. England, Assistant Director, Division of Market Regulation (''Division''), Commission, dated December 12, 2002 (''Amendment No. 1''). Amendment No. 1 provides for certain technical changes and clarification to the original proposal.

[4] *See* Securities Exchange Act Release No. 32988 (September 29, 1993), 58 FR 52124 (October 6, 1993) (order approving File No. SR–NASD–93–15), (''1993 Order'').

[5] The actual maturity date will be determined on the day the Notes are priced for initial sale to the public.

[6] The Nasdaq-100 Index is a modified capitalization-weighted index of 100 of the largest non-financial companies listed on The Nasdaq National Market tier of Nasdaq. The Index constitutes a broadly diversified segment of the largest securities listed on The Nasdaq Stock Market and includes companies across a variety of major industry groups. The securities in the Index must, among other things, have an average daily trading volume on Nasdaq of at least National Market. In order to initially be included in the Nasdaq National Market, an issuer must meet a number of financial criteria, including a minimum of: (1) 1.1 million publicly held shares; (2) $8 million in market value of publicly held shares; (3) shareholder's equity of 15 million, or market value of listetd securities of $75 million or total assets and total revenue of $75 million; and (4) a bid price of $1. An issuer may be required to meet higher listing standards depending on the Entry or maintenance Standard under which it qualifies for inclusion in The Nasdaq National Market. *See* Amendment No. 1, *supra* note 3.

No one particular stock or group of stocks dominates the Nasdaq-100 Index. *Id.* As of December 9, 2002, the largest component security presented 13.13% of the Index and the five largest component securities represented 31.9% of the Index. *Id.* In order to limit domination of the Index by a few large stock stocks, the Index is calculated under a ''modified capitalization-weighted'' methodology, which is a hybrid between equal weighting and conventional capitalization weighting. Under the methodology employed, on a quarterly basis coinciding with Nasdaq's quarterly scheduled weight adjustment procedures, the Index Securities are categorized as either ''Large Stocks'' or ''Small Stocks'' depending on whether their current percentage weights (after taking into acocunt such scheduled weight adjustments due to stock repurchases, secondary offerings, or other corporate actions) are greater than, or less than or equal to, the average percentage weight in the Index (*i.e.,* as a 100-stock index, the average percentage weight in the Index is 1.0%). Such quarterly examination will result in an Index rebalancing if either one or both of the following two weight distribution requirements are not met: (1) The current weight of the single largest market capitalization Index component security must be less than or equal to 24.0%, and (2) the ''collective weight'' of those Index component securities whose individual current weights are in excess of 4.5%, when added together, must be less than or equal to 48.0%. Index securities are ranked by market value and are evaluated annually to determine which securities will be included in th e Index. Moreover, if at any time during the yeaer an Index security is no longer trading on the Nasdaq Stock Market, or is otherwise determined by Nasdaq to become ineligible for continued inclusion in the Index, the security will be replaced with the largest market capitalization security not currently in the Index that meets the Index eligibility criteria. For a detailed description of the Nasdaq-100 Index, see the prospectus supplement that will be filed by Merrill Lynch with the Commission prior to the issuance of the Notes.

[7] The actual Capped Value will be determined at the time of issuance of the Notes.