

Commission ("SEC" or "Commission") the proposed rule change as described in Items I and II 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**

Nasdaq proposes to list and trade Performance Leveraged Upside Securities ("PLUS") based on the value of the Nasdaq-100 Index ("Notes") issued by Morgan Stanley & Co., Inc. ("Morgan Stanley").

### **II. Self-Regulatory Organization's Statements 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**

Nasdaq proposes to list and trade Performance Leveraged Upside Securities ("PLUS"), the return on which is based upon the Nasdaq-100 Index.<sup>3</sup>

<sup>3</sup> 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 The Nasdaq Stock Market. The Index constitutes a broadly diversified segment of the largest securities listed on the 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 200,000 shares.

In order to limit domination of the Index by a few large 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 account 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

Under Rule 4420(f), Nasdaq may approve for listing and trading innovative securities which cannot be readily categorized under traditional listing guidelines.<sup>4</sup> Nasdaq proposes to list for trading notes based on the Nasdaq-100 Index under Rule 4420(f).

The Notes, which will be registered under section 12 of the Act, will initially be subject to Nasdaq's listing criteria for other securities under Rule 4420(f). Specifically, under Rule 4420(f)(1):

(A) The issuer shall have assets in excess of \$100 million and stockholders' equity of at least \$10 million.<sup>5</sup> In the case of an issuer which is unable to satisfy the income criteria set forth in paragraph (a)(1), Nasdaq generally will require the issuer to have the following: (i) Assets in excess of \$200 million and stockholders' equity of at least \$10 million; or (ii) Assets in excess of \$100 million and stockholders' equity of at least \$20 million;

(B) There must be a minimum of 400 holders of the security, provided, however, that if the instrument is traded in \$1,000 denominations, there must be a minimum of 100 holders;

(C) For equity securities designated pursuant to this paragraph, there must be a minimum public distribution of 1,000,000 trading units;

(D) The aggregate market value/principal amount of the security will be at least \$4 million.

In addition, Morgan Stanley satisfies the listed marketplace requirement set forth in Rule 4420(f)(2).<sup>6</sup> Lastly,

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 the Index. Moreover, if at any time during the year 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 Morgan Stanley with the Commission prior to the issuance of the Notes.

<sup>4</sup> See Securities Exchange Act Release No. 32988 (September 29, 1993); 58 FR 52124 (October 6, 1993).

<sup>5</sup> Morgan Stanley satisfies this listing criterion.

<sup>6</sup> Rule 4420(f)(2) requires issuers of securities designated pursuant to this paragraph to be listed on The Nasdaq National Market or the New York Stock Exchange ("NYSE") or be an affiliate of a company listed on The Nasdaq National Market or the NYSE; provided, however, that the provisions of Rule 4450 will be applied to sovereign issuers of "other" securities on a case-by-case basis.

pursuant to Rule 4420(f)(3), prior to the commencement of trading of the Notes, Nasdaq will distribute a circular to members providing guidance regarding compliance responsibilities and requirements, including suitability recommendations, and highlighting the special risks and characteristics of the Notes. In particular, Nasdaq will advise members recommending a transaction in the Notes to: (1) Determine that such transaction is suitable for the customer; and (2) have a reasonable basis for believing that the customer can evaluate the special characteristics of, and is able to bear the financial risks of, such transaction.

The Notes will be subject to Nasdaq's continued listing criterion for other securities pursuant to Rule 4450(c). Under this criterion, the aggregate market value or principal amount of publicly-held units must be at least \$1 million. The Notes also must have at least two registered and active market makers as required by Rule 4310(c)(1). Nasdaq will also consider prohibiting the continued listing of the Notes if Morgan Stanley is not able to meet its obligations on the Notes.

The Notes are a series of medium-term, senior non-convertible debt securities that will be issued by Morgan Stanley. The original public offering price of the Notes will be \$10 per PLUS. The Notes will not pay interest and are not subject to redemption by Morgan Stanley or at the option of any beneficial owner before maturity on August 30, 2004.

At maturity, if the value of the Nasdaq-100 Index has increased, a beneficial owner will be entitled to receive a payment on the Notes based on 300% the amount of that percentage increase, subject to a maximum total payment at maturity that is expected to be between \$11.80 and \$12.00 (the "Maximum Payment at Maturity").<sup>7</sup> Thus, the Notes provide investors the opportunity to obtain leveraged returns based on the Nasdaq-100 Index subject to a cap that is expected to represent an appreciation of 18% to 20% over the original issue price of the Notes. Unlike ordinary debt securities, the Notes do not guarantee any return of principal at maturity. Therefore, if the value of the Nasdaq-100 Index has declined at maturity, a beneficial owner will receive less, and possibly significantly less, than the original issue price of \$10 per PLUS.

The payment that a beneficial owner will be entitled to receive at maturity depends entirely on the relation of the

<sup>7</sup> The actual Maximum Payment at Maturity will be determined at the time of issuance of the Notes.