

Commission ("Commission") the proposed rule change as described in Items I and II, which Items have been prepared by Nasdaq. On September 2, 2003, Nasdaq amended the proposed rule change.<sup>3</sup> Nasdaq filed the proposal pursuant to section 19(b)(3)(A) of the Act,<sup>4</sup> and Rule 19b-4(f)(6) thereunder,<sup>5</sup> which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice, as amended, 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 seeks to codify under NASD Rule 4120 Nasdaq's existing authority to implement a "Quote-Only Period" ("Period") before the start of trading in initial public offerings ("IPOs") on Nasdaq. The text of the proposed rule change is below. Proposed new language is in italics.

#### **4120. Trading Halts**

##### **(a) Authority To Initiate Trading Halts**

In circumstances in which Nasdaq deems it necessary to protect investors and the public interest, Nasdaq may, pursuant to the procedures set forth in paragraph (b):

(1)–(6) No Change.

(7) *Halt trading in a security that is the subject of an Initial Public Offering on Nasdaq.*

##### **(b) Procedure for Initiating a Trading Halt**

(1)–(6) No Change.

(7) *A trading halt initiated under Rule 4120(a)(7) shall be terminated when Nasdaq releases the security for trading. Prior to terminating the halt, there will be a 15-minute period during which market participants may enter quotes in that security in Nasdaq systems. If the inside market is not locked or crossed at the conclusion of that 15-minute period, Nasdaq will release the security for trading and terminate the halt. If the inside market is locked or crossed at the conclusion of the initial 15-minute*

*period, Nasdaq will extend the halt for an additional 15 minutes during which quotations may be entered in Nasdaq systems. At the conclusion of the second 15-minute period, the halt shall be terminated and the security released for trading.*

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### **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 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 amend NASD Rule 4120 to codify that NASD members or persons associated with NASD members are prohibited from executing trades, directly or indirectly, in a Nasdaq IPO prior to the conclusion of a quote-only period and the dissemination over the consolidated tape of a trade in that security on the Nasdaq Stock Market.

Section 12 of the Act<sup>6</sup> and Rule 12f-2 thereunder<sup>7</sup> prohibit off-exchange trading of IPOs of exchange-listed securities prior to the first trade on the listing exchange. This prohibition ensures the smooth functioning of the market during the initial trading of these IPOs that might otherwise experience volatility that may be observed in the opening of IPOs for secondary market trading. The prohibition also helps to ensure that markets are not open for trading when unusual circumstances may prevent such markets from remaining fair and orderly. Market participants are better able to digest and respond to market price indications before an IPO is released for trading, and thus to provide better information upon which to make trading decisions.

The Act does not extend this protection to over-the-counter listings such as those on Nasdaq. Therefore, in 1994, Nasdaq established a quotation-only time period for quoting

participants to enter and adjust their first quotations for IPO securities.<sup>8</sup> Prior to the Period, NASD members may not disseminate quotes or trades in the IPO security. During the Period, NASD members are prohibited from effecting trades, either directly or indirectly, in the Nasdaq IPO security. Market participants may freely quote and trade once the Period has ended and Nasdaq has released the security for trading.

In 1998, Nasdaq modified and expanded the Period.<sup>9</sup> As amended and as is current practice, the initial Period lasts for 15 minutes. If the market is locked/crossed at the end of the first 15 minutes of the Period, Nasdaq extends the Period for an additional 15 minutes, after which trading in the security is released. Although Nasdaq monitors quotations for the entire 15 minutes, the determination whether to extend the Period is based solely on whether the market is locked or crossed at the end of that Period.

When the Commission approved Nasdaq's 1998 proposal to extend the Period, Nasdaq noted that its practice of imposing a Period is related to its authority to halt trading pursuant to NASD Rule 4120.<sup>10</sup> NASD Rule 4120 provides Nasdaq with authority to halt trading in securities in a number of circumstances in which Nasdaq deems a trading halt necessary to protect investors and the public interest. Prior to the adoption of the pilot amendment, the specific bases for initiating a trade halt focused primarily on ensuring that all investors have access to material news about an issuer. Nasdaq believes that the IPO Period shares the characteristics that are common to trade halts, including the presence of unusual market conditions and the possible lack of complete information upon which to base investment decisions.

Although Nasdaq's 1998 proposal referenced NASD Rule 4120, Nasdaq did not amend Rule 4120 at that time. Nasdaq believes that it is necessary and appropriate to codify Nasdaq's existing authority as established by Commission approval in 1998. Some market participants have expressed to Nasdaq their confusion or uncertainty about the Period. Therefore, Nasdaq submits this proposal to ensure that its authority is

<sup>3</sup> See August 29, 2003 letter from Edward S. Knight, Executive Vice President and General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, and attachments ("Amendment No. 1"). Amendment No. 1 completely replaces and supersedes the original proposed rule change.

<sup>4</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>5</sup> 17 CFR 240.19b-4(f)(6). The Commission considers the original filing to have satisfied Nasdaq's obligation to provide the Commission with notice of its intention to file the proposed rule change pursuant to Rule 19b-4(f)(6). Nasdaq asked the Commission to waive the 30-day operative delay.

<sup>6</sup> 15 U.S.C. 78l.

<sup>7</sup> 17 CFR 240.12f-2.

<sup>8</sup> See Securities Exchange Act Release 34254 (June 24, 1994), 59 FR 33808 (June 30, 1994)(SR-NASD-94-37).

<sup>9</sup> See Securities Exchange Act Release 40968 (January 22, 1999), 64 FR 4729 (January 29, 1999)(SR-NASD-98-98).

<sup>10</sup> *Id.* at footnote 4. Specifically, Nasdaq stated that the Quote Only Period "like the objectives in [NASD] Rule 4120, is designed to ensure that the market is not open for trading when unusual circumstances may prevent such markets from remaining fair and orderly."