

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

The Exchange does not believe that the proposed rule change will impose any inappropriate burden on competition.

### C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

No written comments were solicited or received by the Exchange relating to this submission.<sup>6</sup>

### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The Exchange has designated the proposed rule change as a fee change pursuant to Section 19(b)(3)(A)(ii) of the Act<sup>7</sup> and Rule 19b-4(f)(2) thereunder.<sup>8</sup> Accordingly, the proposal will take effect upon filing with the Commission. At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purpose of the Act.

### IV. 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 at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at

<sup>6</sup> At the request of CHX, this sentence was revised to clarify that the Exchange did not solicit comment from its members. Telephone call between Florence E. Harmon, Senior Special Counsel, Division of Market Regulation, Commission, and Ellen Neely, Senior Vice President and General Counsel, CHX, on May 14, 2002.

<sup>7</sup> 15 U.S.C. 78f(b).

<sup>8</sup> 15 U.S.C. 78f(b)(4).

the principal office of the CHX. All submissions should refer to File No. SR-CHX-2002-13 and should be submitted by June 10, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>9</sup>

Jill M. Peterson,

Assistant Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45920; File No. SR-NASD-2002-45]

### Self-Regulatory Organizations; Notice of Filing and Order Granting Partial Accelerated Approval of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto by the National Association of Securities Dealers, Inc. to Establish Listing Standards and Listing Fees for Portfolio Depository Receipts and Index Fund Shares

May 13, 2002.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on April 3, 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 May 6, 2002, Nasdaq filed Amendment No. 1 to the proposal.<sup>3</sup> On May 13, 2002, Nasdaq filed Amendment No. 2 to the proposal.<sup>4</sup> The Commission is

<sup>9</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See letter from John D. Nachmann, Senior Attorney, Nasdaq, to Katherine A. England, Assistant Director, Division of Market Regulation ("Division"), Commission, dated May 3, 2002 ("Amendment No. 1"). In Amendment No. 1, Nasdaq did the following: (1) Made corrections to its proposed rule text and proposal; (2) added discussion and stated its statutory basis for the proposed listing fees; (3) clarified that its regular trading hours for Portfolio Depository Receipts ("PDRs") and Index Fund Shares ("Fund Shares") will be from 9:30 a.m. to 4 p.m. or 4:15 p.m., as designated by Nasdaq; and (4) requested accelerated approval for the portion of the proposal relating to the listing and trading standards for PDRs and Fund Shares, and not for the portion on the proposed listing fees.

<sup>4</sup> See letter from John D. Nachmann, Senior Attorney, Nasdaq, to Katherine A. England, Assistant Director, Division, Commission, dated May 13, 2002 ("Amendment No. 2"). In Amendment No. 2, Nasdaq removed the term

publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons and is granting partial accelerated approval to the proposal.<sup>5</sup>

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

Nasdaq proposes to establish listing standards and listing fees for PDRs and Fund Shares.

Proposed new language is *italicized*; proposed deletions are in [brackets].

\* \* \* \* \*

#### 4420. Quantitative Designation Criteria

In order to be designated for the Nasdaq National Market, an issuer shall be required to substantially meet the criteria set forth in paragraphs (a), (b), (c), (d), (e), (f), [or] (g), (h), (i), or (j) below. Initial Public Offerings substantially meeting such criteria are eligible for immediate inclusion in the Nasdaq National Market upon prior application and with the written consent of the managing underwriter that immediate inclusion is desired. All other qualification issues, exception special situations, are included on the next inclusion date established by Nasdaq.

(a)-(h) No change.

#### (i) Portfolio Depository Receipts

(1) *Definitions. The following terms shall, unless the context otherwise requires, have the meanings herein specified:*

(A) *Portfolio Depository Receipt. The term "Portfolio Depository Receipt" means a security:*

- (i) *that is based on a unit investment trust ("Trust") which holds the securities which comprise an index or portfolio underlying a series of Portfolio Depository Receipts;*
- (ii) *that is issued by the Trust in a specified aggregate minimum number in return for a "Portfolio Deposit" consisting of specified numbers of shares of stock plus a cash amount;*
- (iii) *that, when aggregated in the same specified minimum number, may be redeemed from the Trust which will pay to the redeeming holder the stock and cash then comprising the "Portfolio Deposit"; and*
- (iv) *that pays holders a periodic cash payment corresponding to the regular cash dividends or distributions declared with respect to the component securities of the stock index or portfolio of*

"member organization" throughout its proposed rule text and proposal.

<sup>5</sup> Nasdaq requested accelerated approval of all portions of the proposal except those that deal with its proposed new listing fees.

securities underlying the Portfolio Depository Receipts, less certain expenses and other charges as set forth in the Trust prospectus.

(B) Reporting Authority. The term "Reporting Authority" in respect to a particular series of Portfolio Depository Receipts means Nasdaq, a wholly-owned subsidiary of Nasdaq, an institution (including the Trustee for a series of Portfolio Depository Receipts), or a reporting service designated by Nasdaq or its subsidiary as the official source for calculating and reporting information relating to such series, including, but not limited to, any current index or portfolio value; the current value of the portfolio of securities required to be deposited to the Trust in connection with issuance of Portfolio Depository Receipts; the amount of any dividend equivalent payment or cash distribution to holders of Portfolio Depository Receipts, net asset value, and other information relating to the creation, redemption or trading of Portfolio Depository Receipts.

Nothing in this paragraph shall imply that an institution or reporting service that is the source for calculating and reporting information relating to Portfolio Depository Receipts must be designated by Nasdaq; the term "Reporting Authority" shall not refer to an institution or reporting service not so designated.

(2) The provisions of this Rule apply only to series of Portfolio Depository Receipts that are the subject of an order by the Securities and Exchange Commission exempting such series from certain prospectus delivery requirements under Section 24(d) of the Investment Company Act of 1940. Nasdaq will inform members regarding application of this Rule to a particular series of Portfolio Depository Receipts by means of an Information Circular prior to commencement of trading in such series.

Nasdaq requires that members provide to all purchasers of a series of Portfolio Depository Receipts a written description of the terms and characteristics of such securities, not later than the time a confirmation of the first transaction in such series is delivered to such purchaser. In addition, members shall include such a written description with any sales material relating to a series of Portfolio Depository Receipts that is provided to customers or the public. Any other written materials provided by a member to customers or the public making specific reference to a series of Portfolio Depository Receipts as an investment vehicle must include a statement in substantially the following form: "A

circular describing the terms and characteristics of [the series of Portfolio Depository Receipts] has been prepared by [Trust name] and is available from your broker or Nasdaq. It is recommended that you obtain and review such circular before purchasing [the series of Portfolio Depository Receipts]. In addition, upon request you may obtain from your broker a prospectus for [the series of Portfolio Depository Receipts]."

A member carrying an omnibus account for a non-member broker-dealer is required to inform such non-member that execution of an order to purchase a series of Portfolio Depository Receipts for such omnibus account will be deemed to constitute agreement by the non-member to make such written description available to its customers on the same terms as are directly applicable to members under this rule.

Upon request of a customer, a member shall also provide a prospectus for the particular series of Portfolio Depository Receipts.

(3) Nasdaq may approve a series of Portfolio Depository Receipts for listing and trading pursuant to Rule 19b-4(e) under the Securities Exchange Act of 1934, provided each of the following criteria is satisfied:

(A) Eligibility Criteria for Index Components. Upon the initial listing of a series of Portfolio Depository Receipts, the component stocks of an index or portfolio underlying such series of Portfolio Depository Receipts shall meet the following criteria:

(i) Component stocks that in the aggregate account for at least 90% of the weight of the index or portfolio shall have a minimum market value of at least \$75 million;

(ii) The component stocks shall have a minimum monthly trading volume during each of the last six months of at least 250,000 shares for stocks representing at least 90% of the weight of the index or portfolio;

(iii) The most heavily weighted component stock cannot exceed 30% of the weight of the index or portfolio, and the five most heavily weighted component stocks cannot exceed 65% of the weight of the index or portfolio;

(iv) The underlying index or portfolio must include a minimum of 13 stocks; and

(v) All securities in an underlying index or portfolio must be listed on a national securities exchange or The Nasdaq Stock Market (including The Nasdaq SmallCap Market).

(B) Index Methodology and Calculation.

(i) The index underlying a series of Portfolio Depository Receipts will be

calculated based on either the market capitalization, modified market capitalization, price, equal-dollar or modified equal-dollar weighting methodology;

(ii) If the index is maintained by a broker-dealer, the broker-dealer shall erect a "fire wall" around the personnel who have access to information concerning changes and adjustments to the index and the index shall be calculated by a third party who is not a broker-dealer; and

(iii) The current index value will be disseminated every 15 seconds over the Nasdaq Trade Dissemination System.

(C) Disseminated Information. The Reporting Authority will disseminate for each series of Portfolio Depository Receipts an estimate, updated every 15 seconds, of the value of a share of each series. This may be based, for example, upon current information regarding the required deposit of securities and cash amount to permit creation of new shares of the series or upon the index value.

(D) Initial Shares Outstanding. A minimum of 100,000 shares of a series of Portfolio Depository Receipts is required to be outstanding at start-up of trading.

(E) Surveillance Procedures. NASD Regulation will implement written surveillance procedures for Portfolio Depository Receipts.

(4) Trading will occur between 9:30 a.m. and either 4:00 p.m. or 4:15 p.m. for each series of Portfolio Depository Receipts, as specified by Nasdaq.

(5) Nasdaq may list and trade Portfolio Depository Receipts based on one or more stock indexes or securities portfolios. The Portfolio Depository Receipts based on each particular stock index or portfolio shall be designated as a separate series and shall be identified by a unique symbol. The stocks that are included in an index or portfolio on which Portfolio Depository Receipts are based shall be selected by Nasdaq or its agent, a wholly-owned subsidiary of Nasdaq, or by such other person as shall have a proprietary interest in and authorized use of such index or portfolio, and may be revised from time to time as may be deemed necessary or appropriate to maintain the quality and character of the index or portfolio.

(6) A Trust upon which a series of Portfolio Depository Receipts is based will be listed and traded on Nasdaq subject to application of the following criteria:

(A) Initial Listing—for each Trust, Nasdaq will establish a minimum number of Portfolio Depository Receipts required to be outstanding at the time of commencement of trading on Nasdaq.

(B) *Continued Listing*—following the initial twelve month period following formation of a Trust and

commencement of trading on Nasdaq, Nasdaq will consider the suspension of trading in or removal from listing of a Trust upon which a series of Portfolio Depository Receipts is based under any of the following circumstances:

(i) if the Trust has more than 60 days remaining until termination and there are fewer than 50 record and/or beneficial holders of Portfolio Depository Receipts for 30 or more consecutive trading days; or

(ii) if the value of the index or portfolio of securities on which the Trust is based is no longer calculated or available; or

(iii) if such other event shall occur or condition exists which in the opinion of Nasdaq, makes further dealings on Nasdaq inadvisable.

Upon termination of a Trust, Nasdaq requires that Portfolio Depository Receipts issued in connection with such Trust be removed from listing. A Trust may terminate in accordance with the provisions of the Trust prospectus, which may provide for termination if the value of securities in the Trust falls below a specified amount.

(C) *Term*—the stated term of the Trust shall be as stated in the Trust prospectus. However, a Trust may be terminated under such earlier circumstances as may be specified in the Trust prospectus.

(D) *Voting*—voting rights shall be as set forth in the Trust prospectus. The Trustee of a Trust may have the right to vote all of the voting securities of such Trust.

(7) Neither Nasdaq, the Reporting Authority nor any agent of Nasdaq shall have any liability for damages, claims, losses or expenses caused by any errors, omissions, or delays in calculating or disseminating any current index or portfolio value, the current value of the portfolio of securities required to be deposited to the Trust; the amount of any dividend equivalent payment or cash distribution to holders of Portfolio Depository Receipts; net asset value; or other information relating to the creation, redemption or trading of Portfolio Depository Receipts, resulting from any negligent act or omission by Nasdaq, the Reporting Authority, or any agent of Nasdaq or any act, condition or cause beyond the reasonable control of Nasdaq, its agent, or the Reporting Authority, including, but not limited to, an act of God; fire; flood; extraordinary weather conditions; war; insurrection; riot; strike; accident; action of government; communications or power failure; equipment or software

malfunction; or any error, omission or delay in the reports of transactions in one or more underlying securities.

(j) *Index Fund Shares*

(1) *Definitions*. The following terms shall, unless the context otherwise requires, have the meanings herein specified:

(A) *Index Fund Share*. The term “Index Fund Share” means a security:

(i) that is issued by an open-end management investment company based on a portfolio of stocks that seeks to provide investment results that correspond generally to the price and yield performance of a specified foreign or domestic stock index;

(ii) that is issued by such an open-end management investment company in a specified aggregate minimum number in return for a deposit of specified numbers of shares of stock and/or a cash amount with a value equal to the next determined net asset value; and

(iii) that, when aggregated in the same specified minimum number, may be redeemed at a holder's request by such open-end investment company which will pay to the redeeming holder the stock and/or cash with a value equal to the next determined net asset value.

(B) *Reporting Authority*. The term “Reporting Authority” in respect of a particular series of Index Fund Shares means Nasdaq, a wholly-owned subsidiary of Nasdaq, or an institution or reporting service designated by Nasdaq or its subsidiary as the official source for calculating and reporting information relating to such series, including, but not limited to, any current index or portfolio value; the current value of the portfolio of any securities required to be deposited in connection with issuance of Index Fund Shares; the amount of any dividend equivalent payment or cash distribution to holders of Index Fund Shares, net asset value, and other information relating to the issuance, redemption or trading of Index Fund Shares.

Nothing in this paragraph shall imply that an institution or reporting service that is the source for calculating and reporting information relating to Index Fund Shares must be designated by Nasdaq; the term “Reporting Authority” shall not refer to an institution or reporting service not so designated.

(2) The provisions of this Rule apply only to series of Index Fund Shares that are the subject of an order by the Securities and Exchange Commission exempting such series from certain prospectus delivery requirements under Section 24(d) of the Investment Company Act of 1940. Nasdaq will inform members regarding application

of this Rule to a particular series of Index Fund Shares by means of an Information Circular prior to commencement of trading in such series.

Nasdaq requires that members provide to all purchasers of a series of Index Fund Shares a written description of the terms and characteristics of such securities, in a form prepared by the open-end management investment company issuing such securities, not later than the time a confirmation of the first transaction in such series is delivered to such purchaser. In addition, members shall include such a written description with any sales material relating to a series of Index Fund Shares that is provided to customers or the public. Any other written materials provided by a member to customers or the public making specific reference to a series of Index Fund Shares as an investment vehicle must include a statement in substantially the following form: “A circular describing the terms and characteristics of [the series of Index Fund Shares] has been prepared by the [open-end management investment company name] and is available from your broker or The Nasdaq Stock Market. It is recommended that you obtain and review such circular before purchasing [the series of Index Fund Shares]. In addition, upon request you may obtain from your broker a prospectus for [the series of Index Fund Shares].”

A member carrying an omnibus account for a non-member broker-dealer is required to inform such non-member that execution of an order to purchase a series of Index Fund Shares for such omnibus account will be deemed to constitute agreement by the non-member to make such written description available to its customers on the same terms as are directly applicable to members under this rule.

Upon request of a customer, a member shall also provide a prospectus for the particular series of Index Fund Shares.

(3) Nasdaq may approve a series of Index Fund Shares for listing and trading pursuant to Rule 19b-4(e) under the Securities Exchange Act of 1934, provided each of the following criteria is satisfied:

(A) *Eligibility Criteria for Index Components*. Upon the initial listing of a series of Index Fund Shares, each component of an index or portfolio underlying a series of Index Fund Shares shall meet the following criteria:

(i) Component stocks that in the aggregate account for at least 90% of the weight of the index or portfolio shall

have a minimum market value of at least \$75 million;

(ii) The component stocks shall have a minimum monthly trading volume during each of the last six months of at least 250,000 shares for stocks representing at least 90% of the weight of the index or portfolio;

(iii) The most heavily weighted component stock cannot exceed 30% of the weight of the index or portfolio, and the five most heavily weighted component stocks cannot exceed 65% of the weight of the index or portfolio;

(iv) The underlying index or portfolio must include a minimum of 13 stocks; and

(v) All securities in an underlying index or portfolio must be listed on a national securities exchange or The Nasdaq Stock Market (including The Nasdaq SmallCap Market).

**(B) Index Methodology and Calculation**

(i) The index underlying a series of Index Fund Shares will be calculated based on either the market capitalization, modified market capitalization, price, equal-dollar or modified equal-dollar weighting methodology;

(ii) If the index is maintained by a broker-dealer, the broker-dealer shall erect a "fire wall" around the personnel who have access to information concerning changes and adjustments to the index and the index shall be calculated by a third party who is not a broker-dealer; and

(iii) The current index value will be disseminated every 15 seconds over the Nasdaq Trade Dissemination System.

(C) Disseminated Information. The Reporting Authority will disseminate for each series of Index Fund Shares an estimate, updated every 15 seconds, of the value of a share of each series. This may be based, for example, upon current information regarding the required deposit of securities and cash amount to permit creation of new shares of the series or upon the index value.

(D) Initial Shares Outstanding. A minimum of 100,000 shares of a series of Index Fund Shares is required to be outstanding at start-up of trading.

(E) Surveillance Procedures. NASD Regulation will implement written surveillance procedures for Index Fund Shares.

(4) Trading will occur between 9:30 a.m. and either 4 p.m. or 4:15 p.m. for each series of Index Fund Shares, as specified by Nasdaq.

(5) Nasdaq may list and trade Index Fund Shares based on one or more foreign or domestic stock indexes or securities portfolios. Each issue of Index Fund Shares based on each particular

stock index or portfolio shall be designated as a separate series and shall be identified by a unique symbol. The stocks that are included in an index or portfolio on which a series of Index Fund Shares are based shall be selected by such person, which may be Nasdaq or an agent or wholly-owned subsidiary thereof, as shall have authorized use of such index or portfolio. Such index or portfolio may be revised from time to time as may be deemed necessary or appropriate to maintain the quality and character of the index or portfolio.

(6) Each series of Index Fund Shares will be listed and traded on Nasdaq subject to application of the following criteria:

(A) Initial Listing—for each series, Nasdaq will establish a minimum number of Index Fund Shares required to be outstanding at the time of commencement of trading on Nasdaq.

(B) Continued Listing—following the initial twelve month period following commencement of trading on Nasdaq of a series of Index Fund Shares, Nasdaq will consider the suspension of trading in or removal from listing of such series under any of the following circumstances:

(i) if there are fewer than 50 beneficial holders of the series of Index Fund Shares for 30 or more consecutive trading days; or

(ii) if the value of the index or portfolio of securities on which the series of Index Fund Shares is based is no longer calculated or available; or

(iii) if such other event shall occur or condition exists which in the opinion of Nasdaq, makes further dealings on Nasdaq inadvisable.

Upon termination of an open-end management investment company, Nasdaq requires that Index Fund Shares issued in connection with such entity be removed from listing.

(C) Voting—voting rights shall be as set forth in the applicable open-end management investment company prospectus.

(7) Neither Nasdaq, the Reporting Authority, nor any agent of Nasdaq shall have any liability for damages, claims, losses or expenses caused by any errors, omissions, or delays in calculating or disseminating any current index or portfolio value, the current value of the portfolio of securities required to be deposited to the open-end management investment company in connection with issuance of Index Fund Shares; the amount of any dividend equivalent payment or cash distribution to holders of Index Fund Shares; net asset value; or other information relating to the purchase, redemption or trading of Index Fund Shares, resulting

from any negligent act or omission by Nasdaq, the Reporting Authority or any agent of Nasdaq, or any act, condition or cause beyond the reasonable control of Nasdaq, its agent, or the Reporting Authority, including, but not limited to, an act of God; fire; flood; extraordinary weather conditions; war; insurrection; riot; strike; accident; action of government; communications or power failure; equipment or software malfunction; or any error, omission or delay in the reports of transactions in one or more underlying securities.

**4540. Portfolio Depository Receipts and Index Fund Shares**

**(a) Entry Fee**

(1) When an issuer submits an application for listing a series of Portfolio Depository Receipts or Index Fund Shares in The Nasdaq National Market, it shall pay to The Nasdaq Stock Market, Inc. a listing fee of \$5,000 (which shall include a \$1,000 non-refundable processing fee).

(2) The Board of Directors of The Nasdaq Stock Market, Inc. or its designee may, in its discretion, defer or waive all or any part of the entry fee prescribed herein.

(3) If the application is withdrawn or is not approved, the entry fee (less the non-refundable processing fee) shall be refunded.

**(b) Annual Fee**

(1) The issuer of a series of Portfolio Depository Receipts or Index Fund Shares listed on The Nasdaq National Market shall pay to The Nasdaq Stock Market, Inc. an annual fee calculated on total shares outstanding according to the following schedule:

Up to 1 million shares .....	\$6,500
1+ to 2 million shares .....	7,000
2+ to 3 million shares .....	7,500
3+ to 4 million shares .....	8,000
4+ to 5 million shares .....	8,500
5+ to 6 million shares .....	9,000
6+ to 7 million shares .....	9,500
7+ to 8 million shares .....	10,000
8+ to 9 million shares .....	10,500
9+ to 10 million shares .....	11,000
10+ to 11 million shares .....	11,500
11+ to 12 million shares .....	12,000
12+ to 13 million shares .....	12,500
13+ to 14 million shares .....	13,000
14+ to 15 million shares .....	13,500
15+ to 16 million shares .....	14,000
Over 16 million shares .....	14,500

(2) Total shares outstanding means the aggregate number of shares in all series of Portfolio Depository Receipts or Index Fund Shares to be included in The Nasdaq National Market as shown in the issuer's most recent periodic report required to be filed with the issuer's appropriate regulatory authority

or in more recent information held by Nasdaq.

(3) The Board of Directors of The Nasdaq Stock Market, Inc. or its designee may, in its discretion, defer or waive all or any part of the annual fee prescribed herein.

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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 proposes to adopt listing standards and listing fees for PDRs and Fund Shares. A description of the criteria is set forth below.

a. *Portfolio Depository Receipts*. i. *Listing Requirements*. Nasdaq proposes to adopt criteria for listing and trading PDRs, which are securities that: (1) Are based on a unit investment trust ("Trust") which holds the securities which comprise an index or portfolio underlying a series of PDRs; (2) are issued by the Trust in a specified aggregate minimum number in return for a "Portfolio Deposit" consisting of specified numbers of shares of stock plus a cash amount; (3) when aggregated in the same specified minimum number, may be redeemed from the Trust which will pay to the redeeming holder the stock and cash then comprising the "Portfolio Deposit"; and (4) pay holders a periodic cash payment corresponding to the regular cash dividends or distributions declared with respect to the component securities of the stock index or portfolio of securities underlying the PDRs, less certain expenses and other charges as set forth in the Trust prospectus.

In connection with initial listing, Nasdaq represents that it will establish, for each Trust, a minimum number of PDRs required to be outstanding at the time of commencement of trading on Nasdaq.

With respect to continued listing, following the initial twelve month

period after formation of a Trust and commencement of trading on Nasdaq, Nasdaq represents that it will consider the suspension of trading in or removal from listing of a Trust upon which a series of PDRs is based under any of the following circumstances: (1) If the Trust has more than 60 days remaining until termination and there are fewer than 50 record and/or beneficial holders of PDRs for 30 or more consecutive trading days; (2) if the value of the index or portfolio of securities on which the Trust is based is no longer calculated or available; or (3) if such other event shall occur or condition exists which in the opinion of Nasdaq, makes further dealings on Nasdaq inadvisable. Upon termination of a Trust, Nasdaq represents that it will require that PDRs issued in connection with such Trust be removed from listing. A Trust may terminate in accordance with the provisions of the Trust prospectus, which may provide for termination if the value of securities in the Trust falls below a specified amount.

ii. *Standards to Permit Trading of PDRs Pursuant to Rule 19b-4(e) under the Act*. Nasdaq further proposes to adopt generic listing standards to permit the trading of PDRs pursuant to Rule 19b-4(e) under the Act.<sup>6</sup> Rule 19b-4(e) under the Act permits self-regulatory organizations ("SROs") to list and trade new derivative products that comply with existing SRO trading rules, procedures, surveillance programs and listing standards, without submitting a proposed rule change under Section 19(b) of the Act. Accordingly, Nasdaq proposes to adopt the following listing standards in order to list PDRs pursuant to Rule 19b-4(e) under the Act.

Upon initial listing of PDRs, component stocks must in the aggregate account for at least 90% of the weight of the index or portfolio shall have a minimum market value of at least \$75 million. In addition, the component stocks shall have a minimum monthly trading volume during each of the last six months of at least 250,000 shares for stocks representing at least 90% of the weight of the index or portfolio. Moreover, the most heavily weighted component stock cannot exceed 30% of the weight of the index or portfolio, and the five most heavily weighted component stocks cannot exceed 65% of the weight of the index or portfolio. The underlying index or portfolio must include a minimum of 13 stocks. Lastly, all securities in an underlying index or portfolio must be listed on a national securities exchange or The Nasdaq

Stock Market (including The Nasdaq SmallCap Market).

The index underlying a series of PDRs will be calculated based on either the market capitalization, modified market capitalization, price, equal-dollar or modified equal-dollar weighting methodology. In addition, if the index is maintained by a broker-dealer, the broker-dealer shall erect a "fire wall" around the personnel who have access to information concerning changes and adjustments to the index and the index shall be calculated by a third party who is not a broker-dealer.

The current index value will be disseminated every 15 seconds over the Nasdaq Trade Dissemination System. The Reporting Authority will disseminate for each series of PDRs an estimate, updated every 15 seconds, of the value of a share of each series. This may be based, for example, upon current information regarding the required deposit of securities and cash amount to permit creation of new shares of the series or upon the index value.

A minimum of 100,000 shares of a series of PDRs is required to be outstanding at the start-up of trading. Trading for each series of PDRs will occur between 9:30 a.m. and either 4 p.m. or 4:15 p.m., as specified by Nasdaq.<sup>7</sup> Nevertheless, as with other listed securities, quotes and trades in PDRs may be reported using Nasdaq systems that operate in the extended-hours session from 4 p.m. to 6:30 p.m.<sup>8</sup>

iii. *Disclosure*. Nasdaq represents that it will require members to provide all purchasers of newly issued PDRs with a prospectus. Since the PDRs will be in continuous distribution, the prospectus delivery requirements of Section 5(b)(2) of the Securities Act of 1933 ("Securities Act")<sup>9</sup> will apply to all investors in PDRs, including secondary market purchases on Nasdaq.

<sup>7</sup> At initiation, Nasdaq represents that trading in PDRs will occur until 4 p.m. Nasdaq understands that most other markets that trade PDRs extend their regular trading session until 4:15 p.m., and Nasdaq plans to extend its regular trading session until 4:15 p.m. as soon as technically feasible. Telephone conversation between John D. Nachmann, Senior Attorney, Nasdaq, and Florence Harmon, Senior Special Counsel, Commission, on May 13, 2002.

<sup>8</sup> Trades after the end of the regular trading session will have a ".T" identifier, which will exclude them from the consolidated daily "high," "low," and "close" prices, but they would be included in the daily volume statistics. Telephone conversation between John D. Nachmann, Senior Attorney, Nasdaq, and Florence Harmon, Senior Special Counsel, Commission, on May 13, 2002. See also Securities Exchange Act Release Nos. 42003 (October 13, 1999), 64 FR 56554 (October 20, 1999); and 45503 (March 5, 2002), 67 FR 10955 (March 11, 2002).

<sup>9</sup> 15 U.S.C. 77e(b)(2).

<sup>6</sup> 17 CFR 240.19b-4(e).

With respect to a series of PDRs that are the subject of an order by the SEC exempting such series from certain prospectus delivery requirements under Section 24(d) of the Investment Company Act of 1940 ("Investment Company Act"),<sup>10</sup> Nasdaq represents that it will inform members regarding disclosure obligations with respect to a particular series of PDRs by means of an Information Circular prior to commencement of trading in such series.

For these exempted series, Nasdaq represents that it will require that members provide to all purchasers of a series of PDRs a written description of the terms and characteristics of such securities, not later than the time a confirmation of the first transaction in such series is delivered to such purchaser. In addition, members shall include such a written description with any sales material relating to a series of PDRs that is provided to customers or the public. Any other written materials provided by a member to customers or the public making specific reference to a series of PDRs as an investment vehicle must include a statement in substantially the following form: "A circular describing the terms and characteristics of [the series of Portfolio Depository Receipts] has been prepared by [Trust name] and is available from your broker or Nasdaq. It is recommended that you obtain and review such circular before purchasing [the series of Portfolio Depository Receipts]. In addition, upon request you may obtain from your broker a prospectus for [the series of Portfolio Depository Receipts]."

A member carrying an omnibus account for a non-member broker-dealer is required to inform such non-member that execution of an order to purchase a series of PDRs for such omnibus account will be deemed to constitute agreement by the non-member to make such written description available to its customers on the same terms as are directly applicable to members under this rule.

Upon request of a customer, a member shall also provide a prospectus for the particular series of PDRs.

*iv. Trading of PDRs.* Nasdaq represents that dealings in PDRs will be conducted pursuant to Nasdaq and the NASD's existing equity trading rules. Thus, Nasdaq's general dealing and settlement rules would apply, including its rules on clearance and settlement of securities transactions and its equity margin rules. Other generally applicable Nasdaq equity rules and procedures

would also apply.<sup>11</sup> In addition, NASD Regulation's surveillance procedures for PDRs will be the same as the current surveillance procedures governing equity securities, and will include additional monitoring on key pricing dates.

Prior to the commencement of trading in PDRs, Nasdaq represents that it will issue an Information Circular to members highlighting the characteristics of purchases in PDRs. The Information Circular will discuss, among other things, the special characteristics and risks of trading this type of security, inform members of any obligation to deliver a written product description or prospectus, as applicable, to purchasers of PDRs, and the applicability of the suitability rules. Specifically, 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.<sup>12</sup> Furthermore, as new products are introduced from time to time, Nasdaq believes that it is important that members make every effort to familiarize themselves with each customer's financial situation, trading experience, and ability to meet the risks involved with such products and to make every effort to make customers aware of the pertinent information regarding the products.

With respect to trading halts, Nasdaq represents that the trading of PDRs would be halted, along with trading of all other listed or traded stocks, in the event the "circuit breaker" thresholds are reached.<sup>13</sup> Nasdaq represents that it will disclose the policies regarding trading halts in PDRs in the Information Circular. For a PDR based on an index, such policies would include whether trading has been halted or suspended in the primary market(s) for any combination of underlying stocks accounting for 20% or more of the applicable current index group value.

*b. Index Fund Shares.* 1. *Listing Requirements.* Nasdaq also proposes to

<sup>11</sup> Pursuant to NASD Rule 4613(a)(1)(D), a minimum quotation increment of one penny will apply to transactions of PDRs on The Nasdaq National Market.

<sup>12</sup> See NASD Rule 2310 and NASD IM-2310-2. In addition, NASD Rule 2310(b) requires members to make reasonable efforts to obtain information concerning a customer's financial status, a customer's tax status, a customer's investment objectives, and such other information used or considered to be reasonable by such member or registered representative in making recommendations to the customer.

<sup>13</sup> See NASD IM-4120-4.

adopt criteria for the listing and trading of Fund Shares, which are securities that: (1) Are issued by an open-end management investment company based on a portfolio of stocks that seeks to provide investment results that correspond generally to the price and yield performance of a specified foreign or domestic stock index; (2) are issued by such an open-end management investment company in a specified aggregate minimum number in return for a deposit of specified numbers of shares of stock and/or a cash amount with a value equal to the next determined net asset value; and (3) when aggregated in the same specified minimum number, may be redeemed at a holder's request by such open-end investment company which will pay to the redeeming holder the stock and/or cash with a value equal to the next determined net asset value.

In connection with initial listing, Nasdaq represents that it will establish, for each series, a minimum number of Index Fund Shares required to be outstanding at the time of commencement of trading on Nasdaq.

With respect to continued listing, following the initial twelve month period after commencement of trading on Nasdaq of a series of Index Fund Shares, Nasdaq represents that it will consider the suspension of trading in or removal from listing of such series under any of the following circumstances: (1) If there are fewer than 50 beneficial holders of the series of Index Fund Shares for 30 or more consecutive trading days; (2) if the value of the index or portfolio of securities on which the series of Index Fund Shares is based is no longer calculated or available; or (3) if such other event shall occur or condition exists which in the opinion of Nasdaq, makes further dealings on Nasdaq inadvisable. Upon termination of an open-end management investment company, Nasdaq represents that it will require that Index Fund Shares issued in connection with such entity be removed from listing.

*ii. Standards to Permit Trading of Index Fund Shares Pursuant to Rule 19b-4(e) under the Act.* Nasdaq also proposes to adopt generic listing standards to permit the trading of Fund Shares pursuant to Rule 19b-4(e) under the Act. As previously mentioned, Rule 19b-4(e) under the Act permits SROs to list and trade new derivative products that comply with existing SRO trading rules, procedures, surveillance programs and listing standards, without submitting a proposed rule change under Section 19(b) of the Act. Accordingly, Nasdaq proposes to adopt the following listing standards in order

<sup>10</sup> 15 U.S.C. 80a-24(d)

to list Fund Shares pursuant to Rule 19b-4(e) under the Act.

Upon initial listing of Fund Shares, component stocks must in the aggregate account for at least 90% of the weight of the index or portfolio shall have a minimum market value of at least \$75 million. In addition, the component stocks shall have a minimum monthly trading volume during each of the last six months of at least 250,000 shares for stocks representing at least 90% of the weight of the index or portfolio.

Moreover, the most heavily weighted component stock cannot exceed 30% of the weight of the index or portfolio, and the five most heavily weighted component stocks cannot exceed 65% of the weight of the index or portfolio. The underlying index or portfolio must include a minimum of 13 stocks. Lastly, all securities in an underlying index or portfolio must be listed on a national securities exchange or The Nasdaq Stock Market (including The Nasdaq SmallCap Market).

The index underlying a series of Fund Shares will be calculated based on either the market capitalization, modified market capitalization, price, equal-dollar or modified equal-dollar weighting methodology. In addition, if the index is maintained by a broker-dealer, the broker-dealer shall erect a "fire wall" around the personnel who have access to information concerning changes and adjustments to the index and the index shall be calculated by a third party who is not a broker-dealer.

The current index value will be disseminated every 15 seconds over the Nasdaq Trade Dissemination System. The Reporting Authority will disseminate for each series of Fund Shares an estimate, updated every 15 seconds, of the value of a share of each series. This may be based, for example, upon current information regarding the required deposit of securities and cash amount to permit creation of new shares of the series or upon the index value.

A minimum of 100,000 shares of a series of Fund Shares is required to be outstanding at the start-up of trading. Trading for each series of Fund Shares will occur between 9:30 a.m. and either 4 p.m. or 4:15 p.m., as specified by Nasdaq.<sup>14</sup> Nevertheless, as with other listed securities, quotes and trades in Fund Shares may be reported using Nasdaq systems that operate in the

<sup>14</sup> At initiation, Nasdaq represents that trading in Fund Shares will occur until 4 p.m. Nasdaq understands that most other markets that trade Fund Shares extend their regular trading session until 4:15 p.m., and Nasdaq plans to extend its regular trading session until 4:15 p.m. as soon as technically feasible. Telephone conversation between John D. Nachmann, Senior Attorney, Nasdaq, and Florence Harmon, Senior Special Counsel, Commission, on May 13, 2002.

extended-hours session from 4 p.m. to 6:30 p.m.<sup>15</sup>

*iii. Disclosure.* Nasdaq represents that it will require members to provide all purchasers of newly issued Index Fund Shares with a prospectus. Since the Fund Units will be in continuous distribution, the prospectus delivery requirements of Section 5(b)(2) of the Securities Act<sup>16</sup> will apply to all investors in Index Fund Shares, including secondary market purchases on Nasdaq.

With respect to a series of Index Fund Shares that are the subject of an order by the SEC exempting such series from certain prospectus delivery requirements under Section 24(d) of the Investment Company Act,<sup>17</sup> Nasdaq represents that it will inform members regarding disclosure obligations with respect to a particular series of Index Fund Shares by means of an Information Circular prior to commencement of trading in such series.

For these exempted series, Nasdaq represents that it will require that members provide to all purchasers of a series of Index Fund Shares a written description of the terms and characteristics of such securities, in a form prepared by the open-end management investment company issuing such securities, not later than the time a confirmation of the first transaction in such series is delivered to such purchaser. In addition, members shall include such a written description with any sales material relating to a series of Index Fund Shares that is provided to customers or the public. Any other written materials provided by a member to customers or the public making specific reference to a series of Index Fund Shares as an investment vehicle must include a statement in substantially the following form: "A circular describing the terms and characteristics of [the series of Index Fund Shares] has been prepared by the [open-end management investment company name] and is available from your broker or The Nasdaq Stock Market. It is recommended that you obtain and review such circular before purchasing [the series of Index Fund Shares]. In addition, upon request you

<sup>15</sup> Trades after the end of the regular trading session will have a "T" identifier, which will exclude them from the consolidated daily "high," "low," and "close" prices, but they would be included in the daily volume statistics. Telephone conversation between John D. Nachmann, Senior Attorney, Nasdaq, and Florence Harmon, Senior Special Counsel, Commission, on May 13, 2002. See also Securities Exchange Act Release Nos. 42003 (October 13, 1999), 64 FR 56554 (October 20, 1999); and 45503 (March 5, 2002), 67 FR 10955 (March 11, 2002).

<sup>16</sup> 15 U.S.C. 77e(b)(2).

<sup>17</sup> 15 U.S.C. 80a-24(d).

may obtain from your broker a prospectus for [the series of Index Fund Shares]."

A member carrying an omnibus account for a non-member broker-dealer is required to inform such non-member that execution of an order to purchase a series of Index Fund Shares for such omnibus account will be deemed to constitute agreement by the non-member to make such written description available to its customers on the same terms as are directly applicable to members under this rule.

Upon request of a customer, a member shall also provide a prospectus for the particular series of Index Fund Shares.

*iv. Trading of Fund Shares.* Nasdaq represents that dealings in Fund Shares will be conducted pursuant to Nasdaq and the NASD's existing equity trading rules. Thus, Nasdaq's general dealing and settlement rules would apply, including its rules on clearance and settlement of securities transactions and its equity margin rules. Other generally applicable Nasdaq equity rules and procedures would also apply.<sup>18</sup> In addition, NASD Regulation's surveillance procedures for Fund Shares will be the same as the current surveillance procedures governing equity securities, and will include additional monitoring on key pricing dates.

Prior to the commencement of trading in Fund Shares, Nasdaq represents that it will issue an Information Circular to members highlighting the characteristics of purchases in Fund Shares. The circular will discuss, among other things, the special characteristics and risks of trading this type of security, inform members of the requirement to deliver a prospectus to investors purchasing Fund Shares prior to or concurrently with the confirmation of a transaction, and the applicability of suitability rules. Specifically, 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.<sup>19</sup>

<sup>18</sup> Pursuant to NASD Rule 4613(a)(1)(D), a minimum quotation increment of one penny will apply to transactions of Fund Shares on The Nasdaq National Market.

<sup>19</sup> See NASD Rule 2310 and NASD IM-2310-2. In addition, NASD Rule 2310(b) requires members to make reasonable efforts to obtain information concerning a customer's financial status, a customer's tax status, a customer's investment objectives, and such other information used or considered to be reasonable by such member or registered representative in making recommendations to the customer.

Furthermore, as new products are introduced from time to time, Nasdaq represents that it is important that members make every effort to familiarize themselves with each customer's financial situation, trading experience, and ability to meet the risks involved with such products and to make every effort to make customers aware of the pertinent information regarding the products.

With respect to trading halts, the trading of Fund Shares would be halted, along with trading of all other listed or traded stocks, in the event the "circuit breaker" thresholds are reached.<sup>20</sup> Nasdaq represents that it will disclose the policies regarding trading halts in Fund Shares in the Information Circular. For a Fund Share based on an index, such policies would include whether trading has been halted or suspended in the primary market(s) for any combination of underlying stocks accounting for 20% or more of the applicable current index group value.

*c. Listing Fees.* In addition to listing standards, Nasdaq also proposes to adopt a new listing fee schedule for PDRs and Fund Shares. With respect to entry fees, each series of PDRs and Fund Shares will be assessed a \$5,000 fee, which Nasdaq states is significantly lower than the current entry fees for traditional domestic and foreign equity issues listing on The Nasdaq National Market ("National Market"). Moreover, the proposed annual fees for PDRs and Fund Shares also will be significantly less than the current fees for traditional domestic and foreign equity issues listed on the National Market. Nasdaq represents that the entry and annual fees are designed to cover the costs associated with the listing of PDRs and Fund Shares on the National Market, while allowing Nasdaq to compete for the listing of these securities with national securities exchanges.

## 2. Statutory Basis

Nasdaq believes that the proposed rule change, as amended, is consistent with the provisions of Section 15A(b)(6) of the Act<sup>21</sup> in that the proposed rule change is designed to promote just and equitable principles of trade, 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. In particular, Nasdaq believes that PDRs and Fund Shares will allow investors to: (1) Respond quickly to market changes through intra-day trading opportunities; (2) engage in hedging strategies similar to those used

by institutional investors; and (3) reduce transactions costs for trading a portfolio of securities.<sup>22</sup>

Nasdaq further believes that the proposed rule change, as amended, is consistent with the provisions of Section 15A(b)(5) of the Act<sup>23</sup> in that it provides for the equitable allocation of reasonable dues, fees, and other charges among issuers using the Nasdaq system. The proposed listing fees for PDRs and Fund Shares are less than the current fees for traditional domestic and foreign equity issues listed on the National Market as the regulatory and client services costs associated with PDRs and Fund shares are lower than those for traditional equity issues. Furthermore, Nasdaq represents that the proposed listing fees for PDRs and Fund Shares are designed to cover costs and allow Nasdaq to compete for the listing of these securities with national securities exchanges.

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

Nasdaq does not believe that the proposed rule change will 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*

Written comments were neither solicited nor received.

## III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve the proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

Nasdaq has requested that the Commission find good cause, pursuant to Section 19(b)(2) of the Act,<sup>24</sup> for

<sup>22</sup> See Securities Exchange Act Release No. 42988 (June 28, 2000), 65 FR 42041 (July 7, 2000).

<sup>23</sup> 15 U.S.C. 78o-3(b)(5). Nasdaq represents that it intended to refer to Section 15A(b)(5) of the Act instead of Section 15A(b)(6) of the Act in Amendment No. 1 under "Statutory Basis." Telephone conversation between John D. Nachmann, Senior Attorney, Nasdaq, and Sapna C. Patel, Attorney, Commission, on May 7, 2002.

<sup>24</sup> 15 U.S.C. 78s(b)(2).

approving, prior to the thirtieth day after publication in the **Federal Register**, the portion of the rule proposal related to the listing and trading of PDRs and Fund Shares, as amended.

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, 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 file number SR-NASD-2002-45 and should be submitted by June 10, 2002.

## V. Commission Findings and Order Granting Partial Accelerated Approval of the Proposed Rule Change

Nasdaq has requested that the Commission approve the proposed rule change, as amended, on an accelerated basis, except the portions of the amended proposal related to its proposed listing fees. The Commission notes that it has previously approved the listing and trading of PDRs and Fund Shares on other exchanges.<sup>25</sup>

<sup>25</sup> See, e.g., Securities Exchange Act Release Nos. 31591 (December 11, 1992), 57 FR 60253 (December 18, 1992) (listing and trading of PDRs on the American Stock Exchange LLC ("Amex")); 36947 (March 8, 1996), 61 FR 10606 (March 14, 1996) (listing and trading of Fund Shares on the Amex); 39660 (February 12, 1998), 63 FR 9026 (February 23, 1998) (listing and trading of PDRs on the Boston Stock Exchange, Inc. ("BSE")); 42988 (June 28, 2000), 65 FR 42041 (July 7, 2000) (listing and trading of Fund Shares on the BSE); 39076 (September 15, 1997), 62 FR 49270 (September 19, 1997) (listing and trading of PDRs on the Chicago Stock Exchange, Inc.); 39268 (October 22, 1997), 62 FR 56211 (October 29, 1997) (listing and trading of PDRs on the Cincinnati Stock Exchange, Inc. ("CSE")); 43620 (November 27, 2000), 65 FR 75740 (December 4, 2000) (listing and trading of Fund Shares on the CSE); and 43912 (January 31, 2001), 66 FR 9401 (February 7, 2001) (listing and trading of Fund Shares on the Philadelphia Stock Exchange, Inc.).

<sup>20</sup> See NASD IM-4120-4.

<sup>21</sup> 15 U.S.C. 78o-3(b)(6).

The Commission finds that the portion of the proposed rule change relating to the listing and trading of PDRs and Fund Shares, as amended, is consistent with the requirements of Section 15A(b)(6) of the Act<sup>26</sup> and the rules and regulations thereunder applicable to a national securities association.<sup>27</sup> The Commission believes that the listing and trading of PDRs and Fund Shares on Nasdaq will provide investors with a convenient and flexible way of participating in the securities markets. In particular, the Commission believes that the trading of PDRs and Fund Shares provides investors with increased flexibility in satisfying their investment needs by allowing them to purchase and sell a low-cost security replicating the performance of a broad portfolio of stocks at negotiated prices throughout the business day, and by increasing the availability of PDRs and Fund Shares as an investment tool. The Commission also believes that PDRs and Fund Shares will benefit investors by allowing them to trade securities based on unit investment trusts and open-end management companies in secondary market transactions. Accordingly, the Commission finds that the portion of Nasdaq's proposal relating to listing standards for PDRs and Fund Shares, as amended, will facilitate transactions in securities, remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, protect investors and the public interest, and is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.<sup>28</sup>

#### A. Benefits of PDRs and Fund Shares

The relatively low cost of individual PDRs and Fund Shares makes them attractive to individual retail investors who wish to hold a security replicating the performance of a portfolio of stocks. Moreover, the Commission believes that PDRs and Fund Shares provide investors with several other advantages. In particular, investors are able to trade PDRs and Fund Shares continuously throughout the business day in secondary market transactions at negotiated prices.<sup>29</sup> In contrast,

Investment Company Act Rule 22c-1<sup>30</sup> limits holders and prospective holders of open-end investment company shares to purchasing or redeeming securities of the fund based on the net asset value of the securities held by the fund as designated by the board of directors. Accordingly, PDRs and Fund Shares allow investors to: (1) Respond quickly to market changes through intra-day trading opportunities; (2) engage in hedging strategies not otherwise available to retail investors; and (3) reduce transaction costs for trading a portfolio of securities.

The Commission believes that the listing and trading on Nasdaq of securities like PDRs and Fund Shares, which replicate the performance of a broad portfolio of stocks, can benefit the securities markets by, among other things, helping to reduce the volatility occasionally experienced in these markets.<sup>31</sup>

Although PDRs and Fund Shares are not leveraged instruments and will be regulated like equity instruments subject to Nasdaq's rules governing equity securities, the Commission believes that the unique nature of these products raises certain product design, disclosure, trading and other issues that must be adequately addressed. As discussed more fully below, the Commission believes that Nasdaq has adequately addressed these concerns.

#### C. Disclosure

The Commission believes that the Exchange's proposal should ensure that investors have information that will allow them to be adequately apprised of the terms, characteristics, and risks of trading PDRs and Fund Shares. Investors purchasing PDRs and Fund Shares will be required to receive either a prospectus or, as discussed below, a product description of the PDRs and Fund Shares. If the PDR or Fund Share is not granted relief from prospectus

price of a PDR or a Fund Share comparable to its net asset value, and therefore, arbitrage activity likely will be minimal.

<sup>30</sup> 17 CFR 270.22c-1. Investment Company Act Rule 22c-1 generally provides that a registered investment company issuing a redeemable security, its principal underwriter, and dealers in that security may sell, redeem, or repurchase the security only at a price based on the net asset value next computed after receipt of an investor's request to purchase, redeem, or resell. The net asset value of an open-end investment company generally is computed once daily Monday through Friday, usually after the market's close, as designated by the investment company's board of directors.

<sup>31</sup> See Division, SEC, The October 1987 Market Break (February 1988) and Division, SEC, Market Analysis of October 13, and 16, 1989 (December 1990).

delivery requirements of the Investment Company Act, then investors purchasing PDRs and Fund Shares will be required to receive a prospectus prior to or concurrently with the confirmation of the transaction. Because PDRs and Fund Shares will be in continuous distribution, the prospectus delivery requirements of Section 5(b)(2) of the Securities Act<sup>32</sup> will apply both to initial investors, and to all investors purchasing such securities in secondary market transactions on Nasdaq or the over-the-counter market.

If the particular series of PDRs or Fund Shares is subject to an order by the Commission exempting such series from the prospectus delivery requirements under Section 24(d) of the Investment Company Act,<sup>33</sup> Nasdaq members will provide a written description regarding the product to all PDR and Fund Share investors.

Thus, if the proposed PDRs and Fund Shares are granted relief from the prospectus delivery requirements of the Investment Company Act, they will be subject to proposed Nasdaq listing standards NASD Rules 4420(i)(2) and 4420(j)(2), which provide for the delivery of a product description for series of PDRs and Fund Shares that have been granted relief from the prospectus delivery requirements of the Investment Company Act. Under the proposed NASD Rule 4420(i)(2) and NASD Rule 4420(j)(2) listing standards, the delivery requirement will extend to a member carrying an omnibus account for a non-member broker-dealer, who must notify the non-member to make a product description available to its customers on the same terms as are directly applicable to members. In addition, proposed NASD Rule 4420(i)(2) and NASD Rule 4420(j)(2) provide that a member must deliver a prospectus to a customer upon request.<sup>34</sup>

The Commission also notes that Nasdaq will issue an Information Circular to members prior to the commencement of trading in PDRs or Fund Shares. Nasdaq represents that such Information Circular will highlight the general issues pertaining to the purchase of PDRs and Fund Shares and the specific characteristics of the PDRs or Fund Shares to be purchased. Nasdaq

<sup>32</sup> 15 U.S.C. 77e(b)(2).

<sup>33</sup> 15 U.S.C. 80a-24(d).

<sup>34</sup> This prospectus delivery requirement applies to member broker-dealers that use electronic communication networks.

<sup>26</sup> 15 U.S.C. 78o-3(b)(6).

<sup>27</sup> In approving the proposed rule, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>28</sup> 15 U.S.C. 78o-3(b)(6).

<sup>29</sup> Because of potential arbitrage opportunities, the Commission believes that PDRs and Fund Shares will not trade at a material discount or premium in relation to their net asset value. The mere potential for arbitrage should keep the market

represents that the Information Circular will discuss, among other things, the special characteristics and risks of trading this type of security, inform members of the obligation to deliver a prospectus or written description, as applicable, to purchasers of PDRs or Fund Shares, and the applicability of the suitability rules.

#### *D. Listing and Trading of PDRs and Fund Shares*

The Commission finds that adequate rules and procedures exist to govern the listing and trading of PDRs and Fund Shares. Nasdaq represents that PDRs and Fund Shares will be subject to Nasdaq and the NASD's equity trading rules. PDRs and Fund Shares will be deemed equity securities subject to all Nasdaq and NASD rules governing the trading of equity securities, including, among others, rules governing the listing and de-listing of securities, trading halts, notices to members, responsibilities of the specialist and customer suitability requirements.

Nasdaq represents that transactions for each series of PDRs and Fund Shares will occur between 9:30 a.m. and either 4 p.m. or 4:15 p.m., as specified by Nasdaq.<sup>35</sup> Nevertheless, as with other listed securities, quotes and trades in PDRs and Fund Shares may be reported using Nasdaq systems that operate in the extended-hours session from 4 p.m. to 6:30 p.m.<sup>36</sup> The Commission notes that these trading hours are consistent with those on other exchanges.

In addition, the Commission notes that a Reporting Authority will disseminate an estimate, updated every 15 seconds, of the value of a share of each series of PDRs and Fund Shares on Nasdaq's behalf. Nasdaq represents that such current value will be disseminated

<sup>35</sup> At initiation, Nasdaq represents that trading in PDRs and Fund Shares will occur until 4 p.m. Nasdaq understands that most other markets that trade PDRs and Fund Shares extend their regular trading session until 4:15 p.m., and Nasdaq plans to extend its regular trading session until 4:15 p.m. as soon as technically feasible. Telephone conversation between John D. Nachmann, Senior Attorney, Nasdaq, and Florence Harmon, Senior Special Counsel, Commission, on May 13, 2002.

<sup>36</sup> Trades after the end of the regular trading session will have a ".T" identifier, which will exclude them from the consolidated daily "high," "low," and "close" prices, but they would be included in the daily volume statistics. Telephone conversation between John D. Nachmann, Senior Attorney, Nasdaq, and Florence Harmon, Senior Special Counsel, Commission, on May 13, 2002. See also Securities Exchange Act Release Nos. 42003 (October 13, 1999), 64 FR 56554 (October 20, 1999); and 45503 (March 5, 2002), 67 FR 10955 (March 11, 2002).

every 15 seconds over the Nasdaq Trade Dissemination System.

#### *E. Surveillance*

The Commission notes that Nasdaq has submitted surveillance procedures for the trading of PDRs and Fund Shares. The Commission believes that those procedures, which incorporate and rely upon existing NASD Regulation surveillance procedures governing equity securities, are adequate under the Act. Finally, the Commission believes that the surveillance procedures developed by the NASD are adequate to address concerns associated with the listing and trading of PDRs and Fund Shares, including any concerns associated with purchasing and redeeming Creation Units.

The Commission also notes that concerns are raised when a broker-dealer is involved in the development and maintenance of a stock index upon which products such as PDRs and Fund Shares are based. In that case, the broker-dealer and its affiliate should have procedures designed specifically to address the improper sharing of information. The Commission notes that if a broker-dealer is involved in developing or maintaining a stock index, the index must be calculated by a third party who is not a broker-dealer. The Commission believes that such information barrier procedures will address the unauthorized transfer and misuse of material, non-public information.

The Commission further notes that PDRs and Fund Shares are not leveraged instruments and thus do not require any monitoring procedures in connection with leveraging.

#### *F. Scope of the Commission's Order*

The Commission is approving Nasdaq's proposed listing standards for PDRs and Fund Shares. The Commission specifically notes that, notwithstanding approval of the listing standards for PDRs and Fund Shares, other similarly structured instruments and products, including other ETFs, will require review by the Commission pursuant to Section 19(b) of the Act<sup>37</sup> prior to being traded on Nasdaq.

#### *G. Accelerated Approval*

The Commission finds good cause for partially approving the listing standards portion of the proposed rule change and

<sup>37</sup> 15 U.S.C. 78s(b)(2).

Amendment Nos. 1 and 2 thereto prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. The Commission believes that the eligibility of PDRs and Fund Shares for listing and trading on Nasdaq will provide investors with increased investment choice, and that partial accelerated approval of the proposal relating to the listing and trading of PDRs and Fund Shares will allow investors to take advantage of such increased choice promptly. In addition, the Commission notes that it has previously approved the listing and trading of PDRs and Fund Shares.<sup>38</sup>

In Amendment No. 1 to the proposed rule change, Nasdaq did the following: (1) Made corrections to its proposed rule text and proposal; (2) added discussion and stated its statutory basis for the proposed listing fees; (3) clarified that its regular trading hours for PDRs and Fund Shares will be from 9:30 a.m. to 4 p.m. or 4:15 p.m., as designated by Nasdaq; and (4) requested accelerated approval for the portion of the proposal relating to the listing and trading standards for PDRs and Fund Shares, and not for the portion on the proposed listing fees. In Amendment No. 2, Nasdaq removed the term "member organization" throughout its proposed rule text and proposal.

Accordingly, the Commission believes that there is good cause, consistent with Sections 15A(b)(6) and 19(b)(2) of the Act,<sup>39</sup> for granting partial accelerated approval to the proposed rule change relating to listing standards for PDRs and Fund Shares, as amended.<sup>40</sup>

## **VI. Conclusion**

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act, that the portion of the proposed rule change (SR-NASD-2002-45) relating to the listing and trading of PDRs and Fund Shares, as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>41</sup>

**Jill M. Peterson,**

*Assistant Secretary.*

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<sup>38</sup> See *supra* note 25.

<sup>39</sup> 15 U.S.C. 78o-3(b)(6) and 78s(b)(2).

<sup>40</sup> The proposed listing fees are not being approved, and are only being noticed for comment by the Commission for review under Section 19(b)(2) of the Act, 15 U.S.C. 78s(b)(2).

<sup>41</sup> 17 CFR 200.30-3(a)(12).