

**MEMO# 17691**

June 21, 2004

## **NASDAQ PROPOSED RULE CHANGE RELATING TO NEW OPENING PROCESS**

[17691] June 21, 2004 TO: EQUITY MARKETS ADVISORY COMMITTEE No. 30-04 RE: NASDAQ PROPOSED RULE CHANGE RELATING TO NEW OPENING PROCESS The Securities and Exchange Commission has published for comment a proposed rule change filed by The Nasdaq Stock Market that would establish a new opening process for Nasdaq securities.<sup>1</sup> Specifically, the proposed rule change would modify the pre-market hours trading environment for all Nasdaq securities, create the Nasdaq Opening Cross for Nasdaq's most active stocks, and create a Modified Opening Process for Nasdaq-listed securities that do not participate in the Nasdaq Opening Cross. The most significant aspects of the proposed rule change are summarized below.

I. The Modified Pre-Open Trading Environment The modified pre-opening environment would have three components: (1) elimination of the current "Trade-or-Move" process; (2) creation of pre-opening eligible orders; and (3) opening quotations and pre-opening eligible orders at 9:25 a.m. rather than 9:29:30 a.m. This modified pre-opening process would apply to all Nasdaq-listed securities. The Release notes that since Nasdaq implemented an automated unlocking and uncrossing process that ensures an unlocked market at or shortly after 9:29:30 a.m., the primary function of the Trade-or-Move process has been reduced to maintaining unlocked markets prior to 9:29:30 a.m. The proposal would move this automated unlocking process from 9:29:30 a.m. to 9:25 a.m. and would eliminate the Trade-or-Move process entirely. The proposed rule change also would create new extended-hours (X) orders available for execution prior to the market open and throughout the trading day. These orders would begin executing at 9:25 a.m. through a rather detailed "wake up" process. Finally, the proposed rule change would modify the time-in-force for certain types of orders (i.e., DAY, Immediate or Cancel, and Good-till-Cancel orders) to make those order types ineligible for preopening processing. Those orders would still be available for entry prior to market opening but would not be available for execution until 9:30 a.m.

<sup>1</sup> Securities Exchange Act Release No. 49842 (June 9, 2004) ("Release"). The Release can be found on the SEC's website at <http://www.sec.gov/rules/sro/nasd/34-49842.pdf>.

II. The NASDAQ Opening Cross Under the proposal, certain Nasdaq-listed stocks would be designated to participate in the Nasdaq Opening Cross.<sup>2</sup> The Nasdaq Opening Cross would have three components: (1) the creation of opening order types; (2) the dissemination of an order imbalance indicator via Nasdaq proprietary data feeds; and (3) opening cross processing in the Nasdaq Market Center at 9:30 a.m., which would create a single representative price that would be the Nasdaq Official Opening Price. The Release notes that the Opening Cross would begin with market participants entering "On-Open" and "Opening Imbalance Only" ("OIO") order types in the Nasdaq Market Center. These orders would only be accepted for stocks eligible for participation in the Opening Cross process. The On-Open Orders would not be displayed in the quotation montage or disseminated via any Nasdaq data feeds and would only execute

at the price determined by the Opening Cross. In order to add sufficient liquidity to the market at and prior to the open, Nasdaq would enable market participants to enter OIO orders, which would be priced as limit orders and would not be displayed or disseminated. OIO orders would provide supplemental liquidity and would execute only on the Opening Cross against any imbalance, similar to imbalance only orders on the Nasdaq Closing Cross. OIO orders priced more aggressively than the Nasdaq Market Center Inside ask (bid) before the open would be re-priced to the ask (bid) prior to execution of the Opening Cross. Beginning at 9:28 a.m., Nasdaq would begin disseminating an opening order imbalance indicator on one or more Nasdaq proprietary data feeds.<sup>3</sup> According to the Release, the order imbalance indicator would be disseminated to give participants insight into the state of the book and the opening cross if it were to take place at that time and “add transparency to the market and encourage market participants to add liquidity to the market prior to the open.” In the opening process, the opening book and the Nasdaq Market Center continuous book would be brought together to create a single Nasdaq Opening Cross, which would occur at 9:30 a.m. Nasdaq opening prices would be distributed to the consolidated tape immediately after the Opening Cross. Following the Opening Cross, regular market hours trading would proceed as it does today.

III. The Modified Opening Process

The Release notes that for those Nasdaq securities that do not participate in the Nasdaq Opening Cross, Nasdaq has developed an improved procedure to ensure that all stocks open with an unlocked inside market. Similar to the process that Nasdaq applies at 9:29:30 a.m. to clear locks and crosses, the improved process would “wake up” orders that are eligible for 2 Upon initial implementation, Nasdaq plans to apply the opening cross process to securities included in the Nasdaq 100 Index, the S&P 500 Index, and the Nasdaq Biotech Index. According to the Release, Nasdaq would have the authority to apply the Opening Cross to any and all Nasdaq NMS securities. 3 Similar to the closing order imbalance indicator, the opening imbalance information would include several pieces of information regarding the cross: (1) the near indicative clearing price (the crossing price at which orders in the opening book and Nasdaq Market Center continuous book would clear against each other); (2) the far indicative clearing price (the crossing price at which orders in the opening book would clear against each other); (3) the current inside match price; (4) the number of paired shares; and (5) the imbalance quantity. 3 execution beginning at 9:30 a.m., and process them in an orderly fashion to prevent the creation of locks and crosses. The process would have several steps, each of which occur in strict time priority. Jane G. Heinrichs Assistant Counsel