THE NASDAQ STOCK MARKET
ONE LIBERTY PLAZA, 50TH FLOOR
NEW YORK, NY 10006

June 20, 2006

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: SR-NASDAQ-2006-006

Dear Ms. Morris:

We are writing in response to the comment letters filed with the Securities and Exchange Commission (the "Commission" or "SEC") with regard to the above-captioned rule filing.[1] In the filing, The NASDAQ Stock Market LLC (the "Nasdaq Exchange") proposed a rule to govern affiliations between the Nasdaq Exchange and its members. We believe that the concerns raised by the comment letters are easily addressed, because the letters reflect a fundamental misunderstanding of the proposed rule change.

The Nasdaq Exchange filed the proposed rule change to address a concern that there may be conditions under which the SEC would have a strong policy interest in reviewing an affiliation between a self-regulatory organization (an "SRO"), such as the Nasdaq Exchange, and one its members, even though Section 19 of the Securities Exchange Act of 1934 (the "Act") may not require the submission of a proposed rule change regarding the affiliation. Thus, the proposed rule change is designed to stipulate that the Nasdaq Exchange will file a rule change regarding a proposed affiliation under the circumstances described in Rule 2140 even if the Act does not require it to do so.

The filing recognizes that the Nasdaq Exchange is a subsidiary of The Nasdaq Stock Market, Inc. ("Nasdaq Inc."), a public company that may engage in diverse operations. As well established by SEC Rule 19b-4, the rule filing requirement of

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[1] See Letter from Kim Bang, Bloomberg, L.P., to Nancy M. Morris, Secretary, SEC (May 17, 2006) and Letter from George R. Kramer, Deputy General Counsel, Securities Industry Association, to Nancy M. Morris, Secretary, SEC (May 19, 2006). An e-mail comment filed with regard to the proposed rule change does not actually address the Nasdaq Exchange's filing, but rather objects to rules of the Nasdaq Exchange that requires its members to be broker-dealers. As this concern is not germane to the substance of the proposed rule change, we do not deem a response to this comment to be necessary. See E-mail comment of Richard Gold (April 28, 2006).

Section 19 attaches only to facilities of the SRO.[2] Thus, business ventures that do not constitute SRO facilities, such as the state-regulated insurance brokerages that Nasdaq Inc. owns, are not subject to Section 19 of the Act. The mere fact that an activity not subject to regulation by the Commission is conducted by an affiliate of an SRO does not expand the Commission's jurisdiction to encompass the unregulated activity.[3] Nevertheless, the rule would stipulate the submission of a rule filing if a new acquisition or venture involved a Nasdaq member, based on the strong Commission interest in the terms of an exchange's relationship to its members.

The commenters mistakenly construe the proposed rule as an effort to subvert the Act and exempt the Nasdaq Exchange from the filing requirements that Section 19 imposes. That is neither the intent nor the effect of the rule language. Rule 2140(a) provides that the Nasdaq Exchange and its affiliates may not acquire or maintain an ownership interest in, or engage in a business venture with, a Nasdaq member or an affiliate of a Nasdaq member in the absence of an effective rule filing. Rule 2140(b) then provides that "[n]othing in this rule shall prohibit, or require a filing under Section 19(b) of the Act" in the circumstances described in that part of the rule. The rule says nothing about the circumstances under which Section 19 may itself require a filing; indeed, it could not place limits on the requirements of Section 19 in the absence of an exercise of the Commission's exemptive authority under Section 36 of the Act, and the filing requests no such exemption.

Rule 2140(b) contains exceptions to the filing requirement imposed by paragraph (a) of the rule, but the question of whether a filing is required with respect to circumstances described in paragraph (b) depends on the Act, not the rule. Thus, paragraph (b)(2) provides that the rule does not require a filing in the event that the

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[2] Section 3(a)(27) of the Act, 15 U.S.C. 78c(a)(27), defines "rules" of an exchange or association to include "the constitution, articles of incorporation, bylaws, and rules, or instruments corresponding to the foregoing, of an exchange, [or] association …, and such of the stated policies, practices, and interpretations of such … exchange, [or] association … as the Commission, by rule, may determine to be necessary or appropriate in the public interest or for the protection of investors to be deemed to be rules of such … exchange, [or] association…" SEC Rule 19b-4, 17 C.F.R. 240.19b-4, defines "stated policy, practice, or interpretation" to mean "[a]ny material aspect of the operation of the facilities of the self-regulatory organization" or "[a]ny statement made generally available to persons having or seeking access … to facilities of [ ] the self-regulatory organization ("specified persons") … that establishes or changes any standard, limit, or guideline with respect to (i) the rights, obligations, or privileges of specified persons, or (ii) the meaning, administration, or enforcement of an existing rule" (emphasis added). Section 3(a)(2) of the Act, 15 U.S.C. 3(a)(2), in turn defines facility, with reference to an exchange, as "its premises, … property …, any right to the use of such premises or property or any service thereof for the purpose of effecting or reporting a transaction on an exchange (including, among other things, any system of communication to or from the exchange … maintained by or with the consent of the exchange), and any right of the exchange to the use of any property or service."

[3] Conversely, and contrary to the concerns expressed by the SIA Letter, the Nasdaq Exchange does not believe that it could avoid a filing obligation with respect to a facility of the Nasdaq Exchange merely by housing the facility's operations in an affiliate of the Nasdaq Exchange.

Nasdaq Exchange or an affiliate thereof acquires or maintains an ownership interest in, or engages in a business venture with, an affiliate of a Nasdaq member if the conditions described in the rule relating to information barriers between the Nasdaq Exchange and the Nasdaq member in question are met. Whether Section 19 would require a filing in such circumstances would depend on the nature of the business venture, as it does today. This exception ensures that the rule does not create a new filing requirement merely because Nasdaq Inc. or one of its affiliates engages in a venture with an entity that is not a Nasdaq member but happens to be affiliated with one. For example, if Nasdaq Inc. and a diversified financial services holding company that also owned a Nasdaq member established a new joint venture for trading precious metals in the spot market or for brokering commercial real estate in lower Manhattan,[4] the underlying activity would not be subject to a filing requirement under Section 19, because the joint venture would engage in activities not subject to Commission jurisdiction and would not be operated as a facility of the Nasdaq Exchange. Moreover, although the joint venture would arguably result in an indirect affiliation between the Nasdaq Exchange and the Nasdaq member, the rule would not require a filing either, as long as the conditions regarding separation between the Nasdaq Exchange and the Nasdaq member were observed. On the other hand, if Nasdaq Inc. and the financial services holding company established a joint venture to sell Nasdaq Exchange market data, Section 19 would require a filing in any event.[5]

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[4] We note that these activities are hypothetical examples only, and that Nasdaq Inc. is not currently contemplating such ventures.

[5] The commenters' discussion of an April 2000 exemption granted in connection with Nasdaq Inc.'s acquisition of Financial Systemware, Inc. ("FSI") is entirely inapposite, due to their failure to recognize that Rule 2140 does not purport to alter the scope of Section 19. See Securities Exchange Act Release No. 42713 (April 24, 2000) (2000 SEC LEXIS 807) (the "FSI Exemption"). The FSI Exemption presented a difficult question as to whether a software company offering products that enhanced and simplified a user's interaction with Nasdaq Inc.'s core trading systems would be considered a facility of NASD. Nasdaq Inc. conservatively concluded that it might in some circumstances, and that therefore an exemption from Section 19 would be needed to allow the company to operate without the need to analyze whether each and every product or fee change required a filing. The Commission similarly reached the carefully worded conclusion that "[c]ertain of the functions offered through FSI's products, when considered together with the other services offered by the NASD and its affiliates, could cause such products be considered part of the NASD's facilities." If FSI had designed data base software or video games, however, we believe that no exemption would have been needed because its products could not be deemed facilities of the NASD.

As noted in the comment letters, the FSI Exemption contained conditions not present in Rule 2140(b)(2). Because Rule 2140(b) is not an exemption from Section 19, but rather only from the self-imposed filing requirement of Rule 2140(a), these conditions are not relevant. Certainly, if the Nasdaq Exchange entered into a joint venture to offer a product that was "necessary for broker-dealers to access" the Nasdaq Exchange's "fundamentally important or core services," Section 19 would require a filing with regard to the product, regardless of the identity of its joint venture partner. In the case of a joint venture to design video games, however, Section 19 would have no relevance, and Rule 2140 would require a filing only if (i) the joint venture was with a member or an affiliate of a member, and (ii) the conditions of Rule 2140(b) were not satisfied.

The commenters similarly misconstrue the Nasdaq Exchange's statements regarding activities that do not constitute business ventures within the meaning of the rule. The rule uses the term "business venture" to ensure that its scope is not limited to joint commercial endeavors that take a particular corporate form. Rather, "business venture" is defined as joint activities with an expectation of shared profit and a risk of shared loss from common entrepreneurial efforts. To ensure that the term would not be construed to cover bilateral contractual relations with a member or its affiliates, however, the filing included a non-exclusive list of commercial dealings that would not be deemed "business ventures" under the rule. Again, the commenters jump to the unfounded conclusion that the Rule seeks to create an exemption from Section 19 with respect to all matters discussed in the filing. Again, however, the rule has no effect on the scope of Section 19, which requires its own analysis. Thus, when the Nasdaq Exchange sells market data or transactions services to a member, Section 19 will likely require a filing with regard to aspects of the products, such as the fees to be charged.[6] The portion of the filing being criticized, however, merely states what should be obvious: the sale of products to the member does not constitute a business venture with the member, and therefore does not implicate the rule.

We hope that this letter will help to further the commenters understanding of the intent and effect of the proposed rule change. If you have any questions, please do not hesitate to call me at 301-978-8480.

Sincerely,

Edward S. Knight

Edward S. Knight
Executive Vice President
and General Counsel

cc: The Honorable Christopher Cox, Chairman
The Honorable Paul S. Atkins, Commissioner
The Honorable Roel C. Campos, Commissioner
The Honorable Cynthia A. Glassman, Commissioner
The Honorable Annette L. Nazareth, Commissioner
Robert L.D. Colby, Acting Director, Division of Market Regulation
David Shillman, Associate Director, Division of Market Regulation
Kelly M. Riley, Assistant Director, Division of Market Regulation
Stephen L. Williams, Economist, Division of Market Regulation
Brian G. Cartwright, General Counsel
Dr. Chester Spatt, Chief Economist
Dr. Lois E. Lightfoot, Economist, Office of Economic Analysis

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[6] Conversely, neither Section 19 nor the rule require filings with regard to bilateral contractual relationships where an SRO purchases goods or services.