

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54435; File No. SR-NASDAQ-2006-031)

September 13, 2006

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change to Exempt all Securities Included in the NASDAQ-100 Index from the Price Test Set Forth in NASDAQ Rule 3350(a)

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on August 21, 2006, The NASDAQ Stock Market LLC (“Nasdaq”), filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons. In addition, the Commission is granting accelerated approval of the proposed rule change.

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

Nasdaq has submitted a proposed rule change to exempt all securities included in the Nasdaq-100 Index from the price test set forth in NASDAQ Rule 3350(a). The text of the proposed rule change is below. Proposed new language is underlined.

3350 Short Sale Rule³

(a) – (b) No Change.

(c) (1) – (9) No Change.

(10) Sales of securities included in the Nasdaq 100 Index.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Following discussions with Jeffrey Davis, Associate General Counsel, Nasdaq, Commission staff made technical changes to the proposed rule text.

(d) – (l) No Change.

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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 III below. Nasdaq has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Nasdaq is proposing to amend Rule 3350(c) to create an exemption from the short sale rule for securities included in the Nasdaq-100 Index. The National Association of Securities Dealers, Inc. (“NASD”), on behalf of Nasdaq, filed a similar proposal on June 15, 2006, SR-NASD-2006-076. On August 1, 2006, Nasdaq began operating as a national securities exchange.⁴ Therefore, Nasdaq is filing this proposal as a national securities exchange. The previous filing, SR-NASD-2006-076, was published for notice and comment and no comments were received.⁵

⁴ The Commission approved Nasdaq’s application to register as a national securities exchange on January 13, 2006. See Securities Exchange Act Release No. 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006). On June 30, 2006, the Commission issued an order modifying the conditions for the operation of Nasdaq as a national securities exchange. The Commission’s order enabled Nasdaq to begin operating as an exchange for securities listed on The NASDAQ Stock Market LLC and reported to the Joint Self-Regulatory Organization Plan Governing The Collecting, Consolidation and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on Exchanges on an Unlisted Trading Privileges Basis. See Securities Exchange Act Release No. 54085 (June 30, 2006), 71 FR 38910 (July 10, 2006); See also Securities Exchange Act Release No. 54241 (July 31, 2006), 71 FR 45246 (August 8, 2006).

⁵ The NASD has filed an amendment to SR-NASD-2006-076 to propose a rule change to NASD Rule 5100 (formerly, NASD Rule 3350) that would, if approved, exempt all securities included in the

The NASDAQ-100 Index. First introduced in 1985, the Nasdaq-100 Index was created to track the performance of the largest non-financial companies listed on The Nasdaq Stock Market, Inc. Nasdaq states that the Nasdaq-100 Index Tracking Stock, also known as “QQQ,” is the most actively traded ETF and the most actively traded listed equity security in the U.S. by average daily share trading volume. As of the end of the fourth quarter of 2005, QQQ traded an average of 90.4 million shares per day. Nasdaq notes that QQQ has grown significantly since its inception: from \$14.5 million in assets at the start to \$20.3 billion in assets as of December 31, 2005, and from 300,000 total shares outstanding to 501.95 million at the end of the fourth quarter of 2005.

Nasdaq states that in addition to the QQQ, nearly 150 licensees have contracted with Nasdaq to use the Nasdaq-100 and other Nasdaq indices as benchmarks for the issuing and trading of their global financial products. Nasdaq also states that these third-party underwritten products, such as equity-linked notes, index warrants, certificates of deposits, leveraged products and basket securities, were sold in 32 countries and amounted to \$157.05 billion in underlying notional value as of December 31, 2005. Further, Nasdaq notes that a total of 33 domestic and international mutual funds use this barometer index as a benchmark as well.

Nasdaq notes that, as a result, the Nasdaq-100 stocks are highly liquid. For the month of April 2006, the average daily volume for that group of securities was over 880 million shares. The average daily volume of an individual Nasdaq-100 security was over 8.8 million shares and the mean daily trading value of those securities was over 3.4 million shares.

The Regulation SHO Pilot. Nasdaq notes that on June 23, 2004, the Commission

Nasdaq-100 Index from the NASD’s price test.

approved new and amended short sale regulations in Regulation SHO under the Act. In addition, Nasdaq notes that on July 28, 2004, the Commission issued an order creating a one year Pilot (“Pilot”) suspending the provisions of Rule 10a-1(a) under the Act and any short sale price test of any exchange or national securities association for short sales of certain securities. The Pilot was created pursuant to Rule 202T of Regulation SHO, which established procedures to allow the Commission to temporarily suspend short sale price tests so that the Commission could study the effectiveness of short sale price tests. Nasdaq also notes that on April 20, 2006, the Commission issued an order extending the termination date of the Pilot to August 6, 2007, the date on which temporary Rule 202T expires.

Nasdaq notes that the Pilot exempts a selected list of securities from short sale price test restrictions of SEC Rule 10a-1 and the rules of self regulatory organizations, including Nasdaq Rule 3350. In addition, Nasdaq states that of the roughly 1000 such securities, roughly 47 percent are listed on Nasdaq and, of those, 24 currently are included in the Nasdaq-100 Index.

Rationale for Proposed Exemption. Nasdaq believes that the proposed exemption is consistent with the goals of short sale regulation because the stocks included in the Nasdaq-100 Index are highly liquid and not implicated by the objectives of the short sale rule. In addition, Nasdaq states that Congressional and Commission objectives included allowing relatively unrestricted short selling in an advancing market, preventing short selling at successively lower prices; and preventing short sellers from accelerating a declining market by exhausting all remaining bids at one price level. Thus, Nasdaq believes that given the highly liquid nature of securities listed in the Nasdaq-100

Index, the proposed exemption poses no risk to investors.

Nasdaq believes that this conclusion is supported by the results of the Regulation SHO Pilot to date. Nasdaq asserts that numerous academics have used the implementation of Regulation SHO as a natural experiment to study the affects of price-test exemptions on various measures of market quality and trading behavior. Nasdaq asserts that a recurring finding among these studies is that there is no indication that the pilot increased short-sale volume or volatility, decreased returns, or sacrificed market efficiency. In addition, Nasdaq states that the results also show that bid test rules had little-to-no affect on market quality or trading behavior for Nasdaq pilot stocks. Nasdaq believes that this finding is consistent with the ability of short-sellers to circumvent Nasdaq's bid test rule by routing orders to markets without short-sale restrictions.

Given the highly liquid nature of Nasdaq-100 securities and the absence of a material impact from the removal of price-based short sale restrictions on 24 of those securities, Nasdaq believes it would benefit investors to exempt the remaining stocks in the Nasdaq-100 Index. As Nasdaq describes above, Nasdaq believes that the Nasdaq-100 Index serves as the basis for billions of dollars of assets and trading in the basket of securities that make up the index. Nasdaq believes that the disparity of regulatory treatment between Nasdaq-100 securities that are included in the Pilot and those that are not is inefficient and potentially harmful to investors.

In addition, Nasdaq believes that the proposed exemption will also remove the disparity in short sale regulation that currently exists between markets. Nasdaq states that as opposed to the Nasdaq, which has voluntarily adopted a short sale rule for Nasdaq securities, several exchanges that trade Nasdaq securities do so with no short sale

regulation, encouraging market participants to route short sale orders to their markets to avoid any regulatory restriction. As a result, Nasdaq believes that the level of regulatory protection an investor receives depends almost entirely on the market to which the investor's order is routed. Nasdaq asserts that this disparity harms customers on all markets by forcing traders to choose between bypassing limit orders posted on Nasdaq, delaying executing those orders, or declining to execute. Nasdaq believes that the proposed exemption is designed to help to alleviate these issues.

2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 6 of the Act, in general, and with Section 6(b)(5) of the Act, in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, remove impediments to a free and open market and a national market system, and, in general, to protect investors and the public interest.

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, as amended.

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. 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. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form
[\(<http://www.sec.gov/rules/sro.shtml>\)](http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASDAQ-2006-031 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASDAQ-2006-031. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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 Section, 100 F Street, NE, Washington, DC 20549-1090. Copies of such filing also will be available for inspection and copying at the principal office of Nasdaq. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available

publicly. All submissions should refer to File Number SR-NASDAQ-2006-031 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

After careful consideration, the Commission finds that the proposed rule change is consistent with the requirements of the Act⁶ and the rules and regulations thereunder applicable to a national securities exchange.⁷ In particular, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of Section 6(b)(5) of the Exchange Act,⁸ which requires, among other things, that the Exchange's rules be 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.

Nasdaq Rule 3350 prohibits short sales in Nasdaq Global Market securities at or below the current best (inside) bid displayed in the Nasdaq Market Center when the current best (inside) bid is below the previous best (inside) bid in the security (the "bid test"). Nasdaq Rule 3350 is inapplicable to National Capital Market securities. The proposed rule change amends Nasdaq Rule 3350(c) to exempt from its price test securities included in the Nasdaq-100 Index.

The Commission is currently conducting the Pilot to study and evaluate the

⁶ 15 U.S.C. 78f.

⁷ In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

⁸ 15 U.S.C. 78f(b)(5).

overall effectiveness and necessity of short sale prices tests.⁹ On April 20, 2006, we extended the Pilot in order to maintain the status quo for price tests of Pilot securities while we complete our analysis of the results of the Pilot and conduct any additional rulemaking that we determine may be warranted.¹⁰

We have not reached any conclusions regarding price tests. However, we believe that this proposed rule change is consistent with the statute. In accordance with Section 6(b) of the Act, the proposed amendment is designed to remove impediments to and perfect the mechanism of a free and open market and a national market system. In addition, the proposed amendment does not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. Nasdaq securities are currently not subject to any price test when traded on other exchanges. Currently, Nasdaq and the NASD (for Nasdaq securities traded over the counter and reported to a NASD facility) are the only markets required to apply a price test to Nasdaq securities. Thus, Nasdaq believes it is at a competitive disadvantage with regard to these securities as market participants may make order routing decisions based on this disparity. In addition, we note that the stocks included in the Nasdaq-100 Index are highly liquid and less likely to be subject to manipulation than less liquid stocks.

Nasdaq has requested that the Commission find good cause for approving the proposed rule change prior to the 30th day after publication of notice thereof in the

⁹ See Securities Exchange Act Release No. 50104 (July 28, 2004), 69 FR 48032 (August 6, 2004) (“First Pilot Order”). The Pilot suspended price tests for the following: (1) short sales in the securities identified in Appendix A to the First Pilot Order; (2) short sales in the securities included in the Russell 1000 index effected between 4:15 p.m. EST and the open of the effective transaction reporting plan of the Consolidated Tape Association (“consolidated tape”) on the following day; and (3) short sales in any security not included in paragraphs (1) and (2) effected in the period between the close of the consolidated tape and the open of the consolidated tape on the following day.

¹⁰ See Order Extending Term of Short Sale Pilot, Release No. 34-53684 (April 20, 2006), 71 FR 24765 (April 26, 2006).

Federal Register. The Commission notes that a substantially similar rule filing, SR-NASD-2006-076, that would have exempted all securities included in the Nasdaq-100 Index from the price test in former NASD Rule 3350, was previously filed by NASD on June 15, 2006, through its subsidiary, The Nasdaq Stock Market, Inc., prior to Nasdaq commencing operations as a national securities exchange.¹¹ SR-NASD-2006-076 was published for comment in the Federal Register on June 22, 2006. The Commission received no comments on the proposal. Accordingly, the Commission finds good cause exists, consistent with Sections 6(b)(5) and 19(b)(2) of the Act,¹² to approve the proposed rule change on an accelerated basis, prior to the 30th day after the date of publication of the notice of filing thereof in the Federal Register.

¹¹ See also, supra n. 4.

¹² 15 U.S.C. 78f(b)(5); 15 U.S.C. 78s(b)(2).

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act that the proposed rule change (SR-NASDAQ-2006-031) is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹³

Nancy M. Morris
Secretary

¹³ 17 CFR 200.30-3(a)(12).