

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-59907 File No. SR-NASDAQ-2009-042)

May 12, 2009

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing of Proposed Rule Change to Amend its Limited Liability Agreement

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “Exchange Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that, on April 29, 2009, The NASDAQ Stock Market LLC (“NASDAQ Exchange” or “Exchange”) 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 the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The NASDAQ Exchange is filing this proposed rule change with regard to proposed changes to its Limited Liability Company Agreement (the “Agreement”).<sup>3</sup> The proposed rule change will be implemented as soon as practicable following approval by the Commission. The text of the proposed rule change is available at <http://www.cchwallstreet.com/nasdaq>, at the NASDAQ Exchange’s principal office, and at the Commission’s Public Reference Room.

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

In its filing with the Commission, the NASDAQ Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it

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

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

<sup>3</sup> The Agreement includes and incorporates an exhibit designated as the By-Laws of the NASDAQ Exchange (the “By-Laws”). Under applicable Delaware law, the By-Laws are considered part of the Agreement.

received on the proposed rule change. The text of those statements may be examined at the places specified in Item IV below. The NASDAQ Exchange 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 the Statutory Basis for, the Proposed Rule Change

1. Purpose

On July 24, 2008, NASDAQ OMX acquired the Philadelphia Stock Exchange, Inc. (renamed NASDAQ OMX PHLX, Inc. ("PHLX")), and on August 29, 2008, NASDAQ OMX acquired the Boston Stock Exchange, Incorporated (renamed NASDAQ OMX BX, Inc. ("BX")). Following those acquisitions, the NASDAQ Exchange, PHLX, and BX have been evaluating means to realize synergies in the operations of these three exchanges while maintaining the separate identity and member representation structures of each.

In making this evaluation, the NASDAQ Exchange and its sister exchanges have given consideration to the experiences of their respective boards and have reviewed the governance documents of other exchanges. In particular, the NASDAQ Exchange and the other exchanges have reviewed the board structures established by NYSE Euronext and its exchange subsidiaries. In Securities Exchange Act Release No. 55293,<sup>4</sup> the Commission approved a structure in which certain committees of the board of directors of NYSE Euronext, the public holding company, perform functions for exchange subsidiaries, which do not themselves have these committees. Specifically, the Commission's approval order states that "the NYSE Euronext board of directors will have an audit committee, a human resource and compensation committee, and a nominating and governance committee. Each of the audit committee, human resource and compensation

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<sup>4</sup> Securities Exchange Act Release No. 55293 (February 14, 2007), 72 FR 8033 (February 22, 2007) (SR-NYSE-2006-120).

committee, and nominating and governance committee of the NYSE Euronext board of directors will consist solely of directors meeting the independence requirements of NYSE Euronext.

These committees also will perform relevant functions for NYSE Group,<sup>5</sup> the Exchange,<sup>6</sup> NYSE Market,<sup>7</sup> NYSE Regulation,<sup>8</sup> Archipelago,<sup>9</sup> NYSE Arca,<sup>10</sup> and NYSE Arca Equities,<sup>11</sup> as well as other subsidiaries of NYSE Euronext, except that the board of directors of NYSE Regulation will continue to have its own compensation committee and nominating and governance committee.”

The NASDAQ Exchange and the other exchanges owned by NASDAQ OMX have also considered the experience of the NASDAQ Exchange in operating as a subsidiary of a public company since 2006. During the period, the board of each of the NASDAQ Exchange and its parent corporation (currently NASDAQ OMX, and formerly The Nasdaq Stock Market, Inc.) has appointed its own audit committee and management compensation committee. However, these

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<sup>5</sup> NYSE Group, Inc., the former public holding company of NYSE Euronext’s U.S. exchanges.

<sup>6</sup> New York Stock Exchange LLC (“NYSE”), a registered national securities exchange.

<sup>7</sup> NYSE Market, Inc., a subsidiary of NYSE to which it has delegated certain operational authority.

<sup>8</sup> NYSE Regulation, Inc., a subsidiary of NYSE to which it has delegated certain operational authority.

<sup>9</sup> Archipelago Holdings, Inc., formerly the public holding company of the entities now known as NYSE Arca, Inc. and NYSE Arca Equities, Inc.

<sup>10</sup> NYSE Arca, Inc., a registered national securities exchange.

<sup>11</sup> NYSE Arca Equities, Inc., a subsidiary of NYSE Arca to which it has delegated certain operational authority.

committees at the NASDAQ Exchange level have generally found themselves duplicating the work of other committees at the exchange or holding company level. The NASDAQ OMX audit committee has broad authority to review the financial information that will be provided to shareholders and others, systems of internal controls, and audit, financial reporting and legal and compliance processes. Because NASDAQ OMX's financial statements are prepared on a consolidated basis that includes the financial results of NASDAQ OMX's subsidiaries, including the NASDAQ Exchange and the other exchange subsidiaries, the NASDAQ OMX audit committee's purview necessarily includes these subsidiaries. The committee is composed of four or five directors, all of whom must be independent under the standards established by Section 10A(m) of the Act<sup>12</sup> and Rule 4200(a) of the NASDAQ Exchange. All committee members must be able to read and understand financial statements, and at least one member must have past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background that results in the individual's financial sophistication.

By contrast, the audit committee of the NASDAQ Exchange has a more limited role, focused solely on the exchange entity and its subsidiaries that operate as facilities of the NASDAQ Exchange. As described in the current By-Laws, the primary functions of the audit committee are (i) oversight over financial reporting, (ii) oversight over the systems of internal controls established by management and the Board and the legal and compliance process, (iii) selection and evaluation of independent auditors, and (iv) direction and oversight of the internal audit function. However, to the extent that the committee reviews financial and accounting matters, its activities are duplicative of the activities of the NASDAQ OMX audit committee,

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<sup>12</sup> 15 U.S.C. 78j-1(m).

which is also charged with providing oversight over financial reporting and independent auditor selection for NASDAQ OMX and all of its subsidiaries, including the NASDAQ Exchange, BX, and PHLX and their subsidiaries. Similarly, the NASDAQ OMX audit committee has general responsibility for oversight over internal controls and direction and oversight over the internal audit function for NASDAQ OMX and all of its subsidiaries. Thus, the responsibilities of the exchanges' audit committees are fully duplicated by the responsibilities of the NASDAQ OMX audit committee. Accordingly, the NASDAQ Exchange is proposing to allow the elimination of its audit committee by amending Article III, Section 5 of the By-Laws.<sup>13</sup>

The NASDAQ Exchange believes, however, that even in light of the NASDAQ OMX audit committee's overall responsibilities for internal controls and the internal audit function, it is nevertheless important for the NASDAQ Exchange Board to maintain its own independent oversight over the NASDAQ Exchange's controls and internal audit matters relating to the NASDAQ Exchange's operations. In this regard, the NASDAQ Exchange notes that its regulatory oversight committee currently has broad authority to oversee the adequacy and effectiveness of the NASDAQ Exchange's regulatory and self-regulatory organization responsibilities, and is therefore able to maintain oversight over controls in tandem with the NASDAQ OMX audit committee's overall control oversight responsibilities. Similarly, it is already the practice of NASDAQ OMX's Internal Audit Department ("Department"),<sup>14</sup> which performs internal audit functions for all NASDAQ OMX subsidiaries, to report to the NASDAQ Exchange regulatory oversight committee on all internal audit matters relating to the NASDAQ

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<sup>13</sup> Similarly, BX is proposing elimination of its audit committee (SR-BX-2009-021 (April 29, 2009)). PHLX expects to file a similar proposed rule change in the near future.

<sup>14</sup> See e-mail from John Yetter, Vice President and Deputy General Counsel, NASDAQ OMX Group, Inc., to Christopher W. Chow, Special Counsel, Commission, dated May 5, 2009.

Exchange. This practice will be formally reflected in the Department's written procedures. In addition, to ensure that the NASDAQ Exchange Board retains authority to direct the Department's activities with respect to the NASDAQ Exchange, the Department's written procedures will be amended to stipulate that the NASDAQ Exchange regulatory oversight committee may, at any time, direct the Department to conduct an audit of a matter of concern to it and report the results of the audit both to the NASDAQ Exchange regulatory oversight committee and the NASDAQ OMX audit committee.

The NASDAQ Exchange also proposes to amend Section 4.13 of the By-Laws in order to follow the NYSE Euronext model with respect to allowing the elimination of its compensation committee and the performance of its function by the NASDAQ OMX compensation committee and/or subsidiary boards. The NASDAQ OMX By-Laws provide that its compensation committee considers and recommends compensation policies, programs, and practices for employees of NASDAQ OMX. Because many employees performing work for the NASDAQ Exchange are also employees of NASDAQ OMX, its compensation committee already performs these functions for such employees. Moreover, certain of its senior officers are also officers of NASDAQ OMX and other NASDAQ OMX subsidiaries because their responsibilities relate to multiple entities within the NASDAQ OMX corporate structure. Accordingly, NASDAQ OMX pays these individuals and establishes compensation policy for them. Most notably, the Chief Executive Officer of the NASDAQ Exchange is also an "executive officer" of NASDAQ OMX within the meaning of NASDAQ Exchange Rule 4350. Under that rule, the compensation of executive officers of an issuer of securities, such as the common stock of NASDAQ OMX, that is listed on the NASDAQ Exchange, must be determined by, or recommended to the board of directors for determination by, a majority of independent directors or a compensation committee

comprised solely of independent directors. Accordingly, the NASDAQ OMX board of directors and/or its compensation committee is legally required to establish the compensation for this individual.

To the extent that policies, programs, and practices must also be established for any NASDAQ Exchange officers or employees who are not also NASDAQ OMX officers or employees, the NASDAQ Exchange Board will perform such actions without the use of a compensation committee (but subject to the recusal of Staff Directors).<sup>15</sup> Moreover, as already provided in the Agreement, the regulatory oversight committee of the BX Board must be informed about the compensation and promotion or termination of the BX chief regulatory officer and the reasons therefor, to allow it to provide oversight over decisions affecting this key officer.

The NASDAQ Exchange is also proposing to amend Article III, Section 6 to allow the NASDAQ Exchange Board to eliminate its arbitration and mediation committee, provided that, as is currently the case, the NASDAQ Exchange's arbitration and mediation program is operated by the Financial Industry Regulatory Authority ("FINRA") in accordance with FINRA rules pursuant to a regulatory services agreement.<sup>16</sup> As provided in the Agreement, the arbitration and

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<sup>15</sup> Staff Directors are directors of the NASDAQ Exchange that are also serving as officers. Since the NASDAQ Exchange Board would not be responsible for setting the compensation of any Staff Directors who are also officers of NASDAQ OMX, they would be permitted to participate in discussions concerning compensation of NASDAQ Exchange employees, but would recuse themselves from a vote on the subject to allow the determination to be made by directors that are not officers or employees of the NASDAQ Exchange. If a Staff Director was not also an employee of NASDAQ OMX, that Staff Director would also absent himself or herself from any deliberations regarding his or her compensation.

<sup>16</sup> The NASDAQ Exchange and FINRA are parties to a Regulatory Services Agreement ("RSA") that is dated June 28, 2000 but that did not become operative until July 1, 2006, when the NASDAQ Exchange first began to operate as a national securities exchange. Under the RSA, FINRA provides a comprehensive dispute resolution program for

mediation committee is to advise the Board on the development and maintenance of an equitable and efficient system of dispute resolution that will equally serve the needs of public investors and NASDAQ Exchange members, to monitor rules and procedures governing the conduct of dispute resolution, and to have such other powers and authority as are necessary to effectuate the purposes of the NASDAQ Exchange rules. However, because the NASDAQ Exchange's arbitration and mediation program is operated by FINRA in accordance with FINRA rules, there is no meaningful role for a committee to advise the Board with respect to the operation of the program or the development of rules, nor have the NASDAQ Exchange rules provided the committee with any specific administrative power or authority. Rather, any information needed by the Board or NASDAQ Exchange staff to evaluate the effectiveness of FINRA's administration of the program is obtained through the NASDAQ Exchange's oversight of FINRA's performance through its authority under its regulatory services agreement to obtain reports from FINRA and to conduct audits. Accordingly, the NASDAQ Exchange has concluded that the committee may reasonably be eliminated. However, the Agreement will continue to provide for the establishment of such a committee in the event that the NASDAQ Exchange later opts to establish an arbitration or mediation program that is not operated by FINRA in accordance with FINRA rules. In such an event, the committee would play a role in advising the Board in the manner currently described in the Agreement.

The NASDAQ Exchange is also proposing to make minor changes to its rules governing the selection of Member Representative Directors. Under the Agreement, twenty percent of the

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NASDAQ members. Prior to July 1, 2006, The Nasdaq Stock Market, Inc., which was the predecessor of the NASDAQ Exchange, operated a market as a facility of the National Association of Securities Dealers, Inc. ("NASD"), FINRA's predecessor. Accordingly, neither the NASDAQ Exchange nor its predecessor market has ever operated a dispute resolution program that was not administered by FINRA or NASD.



NASDAQ Exchange's directors are selected through a process in which the NASDAQ Exchange member nominating committee nominates a slate of candidates but members also have the opportunity to nominate alternative candidates. If no alternative candidates are duly nominated by members, the candidates recommended by the member nominating committee are elected. Alternatively, if alternative candidates are nominated, there is a "Contested Election" in which members cast ballots in order to determine who fills the vacancies. In connection with its acquisition by NASDAQ OMX, BX recently adopted a similar process.<sup>17</sup> When Commission staff reviewed the applicable BX filing, staff required that BX adopt a provision providing that a member, either alone or together with its affiliates, may not cast votes representing more than twenty percent of the votes cast for a candidate, and any votes cast by the member, either alone or together with its affiliates in excess of the twenty percent, limit shall be disregarded. The NASDAQ Exchange proposes to amend Article II, Section 2 of the By-Laws to adopt a similar limitation. Similarly, Commission staff suggested that BX adopt clarifications to the definition of "Voting Date," which is analogous to the definition of "Election Date" in the Agreement. The NASDAQ Exchange is now amending Article I of the By-Laws to provide that an Election Date is selected by the Board on an annual basis, but that members only cast votes on such date if there is a Contested Election.

Finally, the NASDAQ Exchange is updating the Agreement to reflect the name change of The Nasdaq Stock Market, Inc. to The NASDAQ OMX Group, Inc.;<sup>18</sup> the name change of National Association of Securities Dealers, Inc. to FINRA;<sup>19</sup> to correct typographical errors in

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<sup>17</sup> Securities Exchange Act Release No. 58324 (August 7, 2008), 73 FR 46936 (August 12, 2008) (SR-BSE-2008-02, -23, -25, SR-BSECC-2001-01).

<sup>18</sup> See Preamble, Signature Page, and Schedule A and B of the Agreement; Article I of the By-Laws.

<sup>19</sup> See Article I of the By-Laws.

the definition of “Industry member” in Article I of the By-Laws and in Section 6 of the Agreement; and to redesignate the Agreement as the “Second Amended Limited Liability Company Agreement of The NASDAQ Stock Market LLC.”<sup>20</sup>

2. Statutory Basis

The NASDAQ Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>21</sup> in general, and furthers the objectives of: (1) Section 6(b)(1) of the Act,<sup>22</sup> which requires a national securities exchange to be so organized and have the capacity to carry out purposes of the Act and to enforce compliance by its members and persons associated with its members with the provisions of the Act; and (2) Section 6(b)(5) of the Act,<sup>23</sup> in that it is designed, among other things, to prevent fraudulent and manipulative acts and practices, 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. Specifically, the proposed rule change will allow the elimination of two Board committees whose roles are limited by the NASDAQ Exchange’s status as a wholly owned subsidiary of NASDAQ

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<sup>20</sup> See Preamble and Signature Page of the Agreement; Preamble of the By-Laws.

<sup>21</sup> 15 U.S.C. 78f(b).

<sup>22</sup> 15 U.S.C. 78(b)(1).

<sup>23</sup> 15 U.S.C. 78f(b)(5).

OMX, thereby allowing directors to focus greater attention on matters falling directly within the purview of the Board, including regulatory quality, market structure, new product initiatives, and review of proposed rule changes. The filing also allows the elimination of the NASDAQ Exchange arbitration and mediation committee, whose role is considerably limited by the NASDAQ Exchange's use of FINRA to manage its arbitration and mediation program. The filing also adopts improvements to the process for selection of Member Representative Directors, to limit the influence of a group of affiliated members over an election. Finally, the filing adopts clarifications, updates terminology, and corrects typographical errors in several provisions of the Agreement.

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

The NASDAQ Exchange 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.

#### 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. 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>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASDAQ-2009-042 on the subject line.

##### Paper comments

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASDAQ-2009-042. 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 Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. 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-2009-042 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>24</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>24</sup> 17 CFR 200.30-3(a)(12).