



Securities Industry Association

120 Broadway • New York, NY 10271-0080 • (212) 608-1500 • Fax (212) 968-0703
1425 K Street, NW • Washington, DC 20005-3500 • (202) 216-2000 • Fax (202) 216-2119
info@sia.com; http://www.sia.com

January 30, 2006

Mr. Christopher Concannon
Executive Vice President, Transaction Services
The NASDAQ Stock Market
One Liberty Plaza
165 Broadway
New York, NY 10006

Re: NASDAQ Services Agreement and Membership Application Materials

Dear Mr. Concannon:

Thank you for your letter dated January 13, 2006 (enclosed), responding to the December 19, 2005 letter from the Securities Industry Association Technology & Regulation Committee and its Market Data Subcommittee (together, the "Committee") regarding the NASDAQ Services Agreement ("Services Agreement"). The Committee appreciates that NASDAQ has addressed certain of our substantive concerns regarding the provision of data by members of the NASDAQ Exchange and NASDAQ's use of that data. We do, however, continue to have concerns about various aspects of the Services Agreement as outlined below.

As originally drafted, NASDAQ's contractual demand that market participants forfeit all rights to market data as a condition of accessing the exchange was at variance with settled law, as to both substance and process. NASDAQ's revised language is now, however, consistent with Regulation NMS in making clear that subscribers have rights and interests in the data they input into NASDAQ's systems. The Committee continues to contend, however, that all "Subscriber Data" should be provided to NASDAQ for its consumption and distribution subject to the same disclaimers under which NASDAQ data is provided to subscribers, and not subject to the general indemnity obligations of subscribers under the Services Agreement. Accordingly, the Committee requests that Section 2.E of the Services Agreement be amended to require NASDAQ to include such disclaimers with any "Subscriber Data" it redistributes pursuant to the Services Agreement.

The Committee acknowledges that NASDAQ addressed some of its concerns relating to the audit provision, certain of the representations, warranties, and provisions

governing liability, and termination for material breach. Finally, we concur with NASDAQ that changes to technical specifications that alter core trading functionality must be filed with the Securities and Exchange Commission ("SEC") as proposed rule changes under Section 19(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 19b-4 thereunder.

We remain troubled, however, that pursuant to the revised Services Agreement, NASDAQ retains the right to make certain other changes unilaterally without approval by its counterparties and without treating the changes as proposed rule changes. NASDAQ declined to make the requested changes to the Services Agreement that would have assured reasonable notice to your subscribers and an opportunity to raise concerns in advance of any amendment to the terms of the Services Agreement. To be clear, the Committee is not suggesting that NASDAQ negotiate each contract term bilaterally with thousands of subscribers individually, but instead for NASDAQ to provide reasonable advance notice to subscribers with an opportunity to raise concerns, before the Services Agreement or, specifically a term related to the "NASDAQ Requirements," is amended.

In your response, you acknowledged that NASDAQ is required to provide notice of any change to NASDAQ's rules under Exchange Act Section 19(b), including any pricing changes. You also stated, however, that "NASDAQ will not provide a notice and comment period for changes made to the scope of the Service and NASDAQ Requirements that do not meet the definition of a 'proposed rule change' in the Act." You indicated that, for those changes NASDAQ deems not to be "rules," NASDAQ will only post notice on NASDAQtrader.com. SIA believes that this provision creates significant ambiguity and confusion because the definition of what constitutes a "rule" is to some degree subjective and NASDAQ has reserved for itself the power to make that determination. As you state in footnote 1, it may be the case that minor "technical specifications" for the NASDAQ System do not amount to either amendments of the Services Agreement or proposed rule changes. We agree that those types of changes are appropriate for notice on NASDAQtrader.com for subscribers' technology management groups to review and evaluate.¹ Such system specification changes generally are technical in nature, however, and fundamentally different from changes that affect subscribers' respective rights and obligations under the Services Agreement. But if NASDAQ reserves for itself the power to make more fundamental changes, subscribers could be inordinately disadvantaged. For example, the changes NASDAQ has now agreed to make to the data license under Section 2 of the Services Agreement are significant, but those changes would be of little true value if NASDAQ could unilaterally revoke them by amending the section without SEC approval following a notice and comment period.

¹ Currently NASDAQ's method of notifying subscribers of such changes is inconsistent, poorly organized and hard to track on its web site. SIA therefore requests that the Services Agreement provide that NASDAQ will post all such changes in sequential order in a readily accessible central location on its web site with an email notice to subscribers of any new changes.

Accordingly, we reiterate that proposed changes to the Services Agreement that affect rights and responsibilities under the agreement have the impact of rules and therefore must be filed as rule changes with the SEC. In any case, SIA does not believe that posting notices of any changes to the Services Agreement on NASDAQtrader.com is sufficient notice and that if NASDAQ thinks a particular change does not rise to the level of a rule, it should send written notice by regular mail or email to persons designated by the subscribers. In addition to alerting subscribers to changes that will affect them, such written notice will also enable subscribers to determine whether they believe the change should instead have been submitted to the SEC as a proposed rule change.

Furthermore, signing the Services Agreement is a prerequisite to becoming a member of the NASDAQ Exchange. Accordingly, it establishes “standards, limits and guidelines” with respect to access to NASDAQ’s exchange facilities and, since those standards, limits, and guidelines are not otherwise embedded in NASDAQ’s existing rules, we believe the Services Agreement must itself be treated as a proposed rule change within the meaning Rule 19b-4. The SEC has held that self-regulatory organizations cannot avoid Section 19(b) rules by couching regulatory provisions as contracts.²

NASDAQ asserts, however, that it put the Services Agreement out for public comment as Exhibit F, Tab 9 to its amended exchange registration application, a combined filing of several hundred pages in length. While the inclusion of the Services Agreement would seem to be recognition on the part of NASDAQ that the proposal does indeed constitute a rule change under Rule 19b-4, attaching the Services Agreement to the exchange application does not discharge NASDAQ’s obligations or resolve the question of proper procedure and notice.

Significantly, the SEC did not approve the Services Agreement. In approving NASDAQ’s exchange registration, the SEC explicitly noted that its approval does not extend to either the NASDAQ NTS Access Order Form or the NASDAQ Services Agreement.³ As a result, we believe the Services Agreement’s status as a proposed rule change was not affected by the Commission’s order.

Finally, NASDAQ’s request that its members sign and return the Services Agreement by February 17, 2006 is premature, because it has not been approved as a rule change pursuant to Section 19(b). We note that NASDAQ has stated that it will not make its services available to those members who have not executed the Services Agreement

² See Exchange Act Release No. 49076, *In the Matter of the Application of Bloomberg LP for review of Action Taken by the New York Stock Exchange, Inc.* (File No. 3-11129) (Jan. 14, 2004).

³ See Exchange Act Release No. 53128, *In the Matter of the Application of The Nasdaq Stock Market LLC for Registration as a National Securities Exchange* (File No. 10-131), n. 92 (Jan. 13, 2006).

by February 17, 2006. We anticipate that members that do sign the Agreement will reserve their rights in view of the Agreement's questionable enforceability and status.⁴

As stated in our December 19th letter, the Committee continues to believe that these issues can be resolved through further discussions between NASDAQ and our members. Please call me at 202-216-2034 to set up a meeting with the Committee where we can discuss these issues further.

Very truly yours,

Melissa MacGregor
Assistant Vice President
and Assistant General Counsel

enclosure

cc: Mary Revell, Associate Vice President, The NASDAQ Stock Market
Robert L. D. Colby, Acting Director, SEC Division of Market Regulation
Elizabeth King, Associate Director, SEC Division of Market Regulation
Kelly Riley, Assistant Director, SEC Division of Market Regulation
Christopher Gilkerson, Charles Schwab & Co., Inc., Chair SIA Technology &
Regulation Committee
Greg Babyak, Bloomberg Tradebook, Chair SIA Market Data Subcommittee
Ira D. Hammerman, Senior Vice President and General Counsel, SIA

⁴ Exchange Act Section 29(b) voids agreements purporting to waive Exchange Act compliance.