SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54333; File No. SR-NASDAQ-2006-021)

August 18, 2006

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto to Modify Certain of Nasdaq's Corporate Governance Standards, Including the Definition of Independent Director

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 July 28, 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.[3] On August 7, 2006, Nasdaq filed Amendment No. 1 to the proposed rule change.[4] The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

Nasdaq proposes to amend Rules 4200(a)(15), IM-4200 and 4350. Nasdaq will implement the proposed rule upon approval by the Commission.

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 A similar filing, SR-NASD-2005-105, was filed by The Nasdaq Stock Market, Inc. to modify NASD rules on August 31, 2005. SR-NASD-2005-105 was withdrawn on July 28, 2006. Nasdaq began operating as a national securities exchange for Nasdaq-listed securities on August 1, 2006. See Securities Exchange Act Release No. 53128 (Jan. 13, 2006), 71 FR 3550 (Jan. 23, 2006) (the "Exchange Approval Order").

4 In Amendment No. 1, Nasdaq made corrections to the text of the proposed rule change. The changes set forth in Amendment No. 1 have been incorporated into this Notice.

The text of the proposed rule change is below. Proposed new language is underlined; proposed deletions are in [brackets].[5]

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4200. Definitions.

(a) For purposes of the Rule 4000 Series, unless the context requires otherwise:

(1) – (14) No change.

(15) "Independent director" means a person other than an executive officer or employee of the company [or its subsidiaries] or any other individual having a relationship which, in the opinion of the [company's] issuer's board of directors, would interfere with the exercise of independent judgement in carrying out the responsibilities of a director. The following persons shall not be considered independent:

(A) a director who is, or at any time during the past three years was, employed by the company [or by any parent or subsidiary of the company];

(B) a director who accepted or who has a Family Member who accepted any [payments] compensation from the company [or any parent or subsidiary of the company] in excess of $60,000 during any period of twelve consecutive months within the three years preceding the determination of independence, other than the following:

(i) compensation for board or board committee service;

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[5] Changes are marked to the rule text that appears in the electronic manual of Nasdaq found at www.complinet.com/nasdaq. These rules became effective on August 1, 2006, when Nasdaq commenced operations as a national securities exchange for Nasdaq-listed securities.

[(ii) payments arising solely from investments in the company's securities;]

(ii[i]) compensation paid to a Family Member who is [a non-executive] an employee (other than an executive officer) of the company [or a parent or subsidiary of the company]; or

(iii[v]) benefits under a tax-qualified retirement plan, or non-discretionary compensation[;].

[(v) loans from a financial institution provided that the loans (1) were made in the ordinary course of business, (2) were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with the general public, (3) did not involve more than a normal degree of risk or other unfavorable factors, and (4) were not otherwise subject to the specific disclosure requirements of SEC Regulation S-K, Item 404;]

[(vi) payments from a financial institution in connection with the deposit of funds or the financial institution acting in an agency capacity, provided such payments were (1) made in the ordinary course of business; (2) made on substantially the same terms as those prevailing at the time for comparable transactions with the general public; and (3) not otherwise subject to the disclosure requirements of SEC Regulation S-K, Item 404; or]

[(vii) loans permitted under Section 13(k) of the Act.]

Provided, however, that in addition to the requirements contained in this paragraph (B), audit committee members are also subject to additional, more stringent requirements under Rule 4350(d).

(C) a director who is a Family Member of an individual who is, or at any time during the past three years was, employed by the company [or by any parent or subsidiary of the company] as an executive officer;

(D) No change.

(E) a director of the [listed company] issuer who is, or has a Family Member who is, employed as an executive officer of another entity where at any time during the past three years any of the executive officers of the [listed company] issuer serve on the compensation committee of such other entity; or

(F) – (G) No change.

(16) – (39) No change.

(b) - (c) No change.

IM-4200. Definition of Independence — Rule 4200(a)(15)

It is important for investors to have confidence that individuals serving as independent directors do not have a relationship with the listed company that would impair their independence. The board has a responsibility to make an affirmative determination that no such relationships exist through the application of Rule 4200. Rule 4200 also provides a list of certain relationships that preclude a board finding of independence. These objective measures provide transparency to investors and companies, facilitate uniform application of the rules, and ease administration. Because Nasdaq does not believe that ownership of company stock by itself would preclude a

board finding of independence, it is not included in the aforementioned objective factors. It should be noted that there are additional, more stringent requirements that apply to directors serving on audit committees, as specified in Rule 4350.

The Rule's reference to the “company” includes any parent or subsidiary of the company. [a] The term "parent or subsidiary" is intended to cover entities the issuer controls and consolidates with the issuer's financial statements as filed with the Commission (but not if the issuer reflects such entity solely as an investment in its financial statements). The reference to executive officer means those officers covered in SEC Rule 16a-1(f) under the Act. In the context of the definition of Family Member under Rule 4200(a)(14), the reference to marriage is intended to capture relationships specified in the Rule (parents, children and siblings) that arise as a result of marriage, such as "in-law" relationships.

The three year look-back periods referenced in paragraphs (A), (C), (E) and (F) of the Rule commence on the date the relationship ceases. For example, a director employed by the company is not independent until three years after such employment terminates.

For purposes of paragraph (A) of the Rule, employment by a director as an executive officer on an interim basis shall not disqualify that director from being considered independent following such employment, provided the interim employment did not last longer than one year. A director would not be considered independent while serving as an interim officer. Similarly, for purposes of paragraph (B) of the Rule, compensation received by a director for former service as an interim executive officer need not be considered as compensation in determining independence after such service, provided such interim employment did not last longer than one year. Nonetheless, the

issuer's board of directors still must consider whether such former employment and any compensation received would interfere with the director's exercise of independent judgment in carrying out the responsibilities of a director. In addition, if the director participated in the preparation of the company's financial statements while serving as an interim executive officer, Rule 4350(d)(2)(A)(iii) would preclude service on the audit committee for three years.

Paragraph (B) of the Rule is generally intended to capture situations where [a payment] compensation is made directly to (or for the benefit of) the director or a Family Member of the director. For example, consulting or personal service contracts with a director or Family Member of the director [or political contributions to the campaign of a director or a Family Member of the director] would be [considered] analyzed under paragraph (B) of the Rule. In addition, political contributions to the campaign of a director or a Family Member of the director would be considered indirect compensation under paragraph (B). Non-preferential payments made in the ordinary course of providing business services (such as payments of interest or proceeds related to banking services or loans by an issuer that is a financial institution or payment of claims on a policy by an issuer that is an insurance company), payments arising solely from investments in the company's securities and loans permitted under Section 13(k) of the Act will not preclude a finding of director independence as long as the payments are non-compensatory in nature. Depending on the circumstances, a loan or payment could be compensatory if, for example, it is not on terms generally available to the public. [Subparagraph (v) clarifies that a loan from a financial institution that was exempt from specific disclosure pursuant to Instruction 3 to SEC Regulation S-K, Item 404(c) will not

preclude a finding of director independence. Subparagraph (vi) clarifies that certain payments from financial institutions will not preclude a finding of director independence. In particular, subparagraph (vi) is intended to capture standard, non-preferential payments made by financial institutions in the ordinary course of business such as interest payments made by a bank on deposits, certificates of deposits, or savings bonds. Furthermore, subparagraph (vi) is intended to capture technical "payments" made by a financial institution to its customers when the financial institution acts as an agent for its customers. For example, when a brokerage firm receives dividends for securities held by a customer, it will make a "payment" of the dividend amount to that customer. Likewise, when a brokerage firm executes a customer's order to sell the customer's securities, it will make a "payment" of the proceeds to the customer. Subparagraph (vi) clarifies that agency payments, such as those described above, shall not preclude a finding of director independence.]

Paragraph (D) of the Rule is generally intended to capture payments to an entity with which the director or Family Member of the director is affiliated by serving as a partner, controlling shareholder or executive officer of such entity. Under exceptional circumstances, such as where a director has direct, significant business holdings, it may be appropriate to apply the corporate measurements in paragraph (D), rather than the individual measurements of paragraph (B). Issuers should contact Nasdaq if they wish to apply the Rule in this manner. The reference to a partner in paragraph (D) is not intended to include limited partners. It should be noted that the independence requirements of paragraph (D) of the Rule are broader than SEC Rule 10A-3(e)(8) under the Act.

Under paragraph (D), a director who is, or who has a Family Member who is, an executive officer of a charitable organization may not be considered independent if the company makes payments to the charity in excess of the greater of 5% of the charity's revenues or $200,000. However, Nasdaq encourages companies to consider other situations where a director or their Family Member and the company each have a relationship with the same charity when assessing director independence.

For purposes of determining whether a lawyer is eligible to serve on an audit committee, SEC Rule 10A-3 under the Act generally provides that any partner in a law firm that receives payments from the issuer is ineligible to serve on that issuer's audit committee. In determining whether a director may be considered independent for purposes other than the audit committee, payments to a law firm would generally be considered under Rule 4200(a)(15)(D), which looks to whether the payment exceeds the greater of 5% of the recipient's gross revenues or $200,000; however, if the firm is a sole proprietorship, Rule 4200(a)(15)(B), which looks to whether the payment exceeds $60,000, applies.

Paragraph (G) of the Rule provides a different measurement for independence for investment companies in order to harmonize with the Investment Company Act of 1940. In particular, in lieu of paragraphs (A)-(F), a director who is an "interested person" of the company as defined in Section 2(a)(19) of the Investment Company Act of 1940, other than in his or her capacity as a member of the board of directors or any board committee, shall not be considered independent.

4350. Qualitative Listing Requirements for Nasdaq National Market and Nasdaq Capital Market Issuers Except for Limited Partnerships

(a) – (c) No change.

(d) Audit Committee

(1) - (4) No change.

(5) Exception

At any time when an issuer has a class of common equity securities (or similar securities) that is listed on another national securities exchange or national securities association subject to the requirements of SEC Rule 10A-3 under the Act, the listing of classes of securities of a direct or indirect consolidated subsidiary or an at least 50% beneficially owned subsidiary of the issuer (except classes of equity securities, other than non-convertible, non-participating preferred securities, of such subsidiary) shall not be subject to the requirements of this paragraph (d).

(e) – (n) 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 IV 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

The purpose of this rule filing is to provide additional clarity and transparency to certain Nasdaq corporate governance standards.

(i) Rule 4200(a)(15)(B) – Compensation Over $60,000

Nasdaq proposes to modify the definition of independent director in Rule 4200(a)(15)(B) to provide that a finding of independence is precluded if a director accepts any compensation from the company or its affiliates in excess of $60,000 during any consecutive twelve month period within the three years prior to the independence determination. Under the existing rule, a director's independence is evaluated based on payments accepted from the company or its affiliates.

Nasdaq first proposed a detailed definition of independent director in 1999, following the recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees.[6] That definition provided that a director would not be considered independent if he or she accepted compensation from the corporation or its affiliates in excess of $60,000 during the prior fiscal year, other than compensation for board service or certain other benefits.[7]

In 2002, following certain corporate scandals, Nasdaq reviewed its corporate governance standards and proposed the rule that exists today. The existing rule, which was approved in November 2003, precludes a finding of independence if a director, or any family member of the director, accepts any payments from the company or any parent or subsidiary of the company in excess of $60,000 during any period of twelve consecutive months within the three years preceding the determination of independence.[8]

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6 See Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees (February 1999).

7 Securities Exchange Act Release No. 42231 (December 14, 1999), 64 FR 71523 (December 21, 1999).

8 Exceptions exist in the current rule for payments arising solely from investments in the company's securities, certain loans and other payments from a financial institution, and loans permitted under Section 13(k) of the Act.

The change in focus from compensation to payments in the rule was intended to address a concern that the rule might not capture certain payments that had been identified as tainting a director's independence. One such payment involved political contributions by a director to the campaign of another director's spouse.

Since the rule was approved, however, Nasdaq staff has been confronted by several examples of "payments" that do not fall within the original intent of the rule and which Nasdaq believes unlikely to taint a director's independence. For example, in the case of a company that is a bank, payments may include amounts such as interest on a director savings account, proceeds from the redemption of a savings bond, or even the return of the director's deposit. The Commission approved rule changes last year that specifically excluded these types of bank payments. In addition, in the case of a company that is an insurance company, payments could include the payment of claims on a director's policy.

Rather than continuing to codify examples of "payments" that should be excluded from the rules as they arise, Nasdaq believes that the more effective approach is to modify the rule to focus on compensation rather than payments. To provide further guidance, Rule IM-4200 would provide specific examples of direct and indirect compensation that would preclude a director's independence under the rule, such as contributions made to the political campaign of a director or family member. Based on its experience, Nasdaq believes that a revised rule based on compensation rather than payments would better capture the types of compensation that bear on a director's independence, while still addressing the issues that gave rise to concerns about the original rule.

The comparable rule of the New York Stock Exchange, Inc. ("NYSE") precludes independence if the director or family member has received direct compensation above a minimum threshold.[9] Accordingly, the proposed rule change will conform this part of the Nasdaq's definition to the NYSE rules, creating more uniformity across market centers with respect to the standards for evaluating a director's independence.

(ii) Rule IM-4200 – Service as a Compensated Interim Officer

Nasdaq also proposes to modify the interpretive material to Rule 4200(a)(15) to provide that past service as a compensated interim officer should not preclude a director from being considered independent. Nasdaq has received inquiries from issuers who have named an independent director as an interim officer until a successor can be found. These companies have asked for clarity as to whether, under the current rules, serving as an interim officer would preclude a director from being considered independent as a result of such service.

Nasdaq has interpreted the existing rules such that a director serving as an interim officer would not be deemed to be a former employee of the company. However, concerns have been raised that compensation paid to these individuals would disqualify many directors from rendering such services. Nasdaq believes that it is appropriate to provide additional transparency to companies in this situation and, in doing so, to offer broader relief to these companies.

Companies that seek the services of an independent director as a temporary officer typically are responding to an urgent internal problem. Furthermore, companies in this position are likely to provide compensation to such persons in an amount greater

[9] Section 303A.02(b)(ii) of the NYSE Listed Company Manual.

than $60,000. Once a permanent replacement is found, and the individual seeks to return to "normal" service as a board member, Nasdaq believes it is unfair to penalize the company by preventing such person from serving as an independent director for another three years. Nasdaq is proposing a clarification to the rule that would address the difficulties faced at such times by issuers, especially smaller companies, that need to fill key executive slots, and are forced by timing exigencies to turn for help to experienced independent directors on their board. Nevertheless, if, while acting as an interim officer, the director participated in the preparation of the company's financial statements, the director would be precluded from serving on the Audit Committee for three years under Rule 4350(d)(2)(A)(iii).

Accordingly, Nasdaq proposes to amend IM-4200 to clarify that after the effective date of this rule, an issuer's Board may determine that a director who served as an officer of the company on an interim basis for up to a year is not precluded from being considered independent solely as a result of that service (including service that occurs before the approval of this proposed change).[10] In order to limit potential abuse of this exception, however, service in this capacity must be limited to not more than one year. Of course, depending upon the magnitude of the compensation and the length of service as an interim officer, a board could still determine on its own – without regard to a "bright line" test – that an individual should not be considered independent. In this respect, the proposed interpretive material reminds companies of the board's obligation to consider such service in making an independence determination.

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[10] A director would not be considered independent while serving as an interim officer. Further, a director could be considered independent following such service only if a determination of independence is not precluded under any other provision of Rule 4200(a)(15).

NYSE rules also provide that compensated service as an interim officer does not disqualify a director from being considered independent following such service.[11] Accordingly, the proposed rule change would result in more uniformity across market centers with respect to how interim service by directors is treated for independence purposes.

(iii) Other changes

Nasdaq also proposes to make other clarifying changes to the corporate governance rules. Specifically, Nasdaq proposes to clarify that the term "non-executive employee" used in Rule 4200(a)(15)(B)(iii) means an employee other than an executive officer, a term defined in the rules by reference to SEC Rule 16a-1(f) under the Act. Further, Nasdaq proposes to clarify that references to "the company" in Rule 4200(a)(15) include any parent or subsidiary of the listed company. Finally, Nasdaq proposes to clarify that an exception to the audit committee requirements contained in Rule 10A-3(c)(2) under the Act for certain issuers that have a listed parent also is applicable to Nasdaq's audit committee requirements.

(iv) Transition

Nasdaq will implement the proposed rule change immediately upon approval by the Commission. In order to facilitate the transition to the new rules, any director that would be considered independent under the existing rules prior to the rule change, but that would no longer be deemed independent under the new rules, would be permitted to

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[11] Commentary to Section 303A.02(b)(i) and (ii) of the NYSE Listed Company Manual.

continue to serve on the issuer's Board of Directors as an independent director until no later than 90 days after the approval of this rule filing.[12]

2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 6 of the Act[13] in general and with Section 6(b)(5) of the Act,[14] in particular. Section 6(b)(5) requires that Nasdaq'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 to protect investors and the public interest. The proposed rule change will benefit investors, issuers' counsel, and member firms by providing additional clarity and transparency to Nasdaq's corporate governance standards and promoting greater uniformity with existing corporate governance standards of the NYSE. The additional clarity, transparency, and greater uniformity will also reduce administrative costs associated with compliance with Nasdaq's corporate governance standards.

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.

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12 The transition period does not affect an issuer's obligation to comply with the requirements related to audit committee composition.

13 15 U.S.C. 78f.

14 15 U.S.C. 78f(b)(5).

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 Nasdaq consents, the Commission will:

(A) by order approve such 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, 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); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASDAQ-2006-021 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-2006-021. 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. Copies of such filing also will be available for inspection and copying at the principal office of the 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-2006-021 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[15]

Nancy M. Morris
Secretary

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[15] 17 CFR 200.30-3(a)(12).