



**Bob Greifeld at the NACD Annual Conference Keynote Address
October 24, 2005**

Introduction:

B. Kenneth West, NACD Chairman: *It's now my pleasure to introduce our next speaker, Bob Greifeld, who since May of 2003 has been president and CEO of the NASDAQ stock market which, as you all know, is the largest electronic stock market in the United States.*

Since joining NASDAQ, Bob has sharpened the strategic focus of that organization with the stated goal of making NASDAQ the best equity market in the universe. I guess I got that right, didn't I, Bob?

Bob brought more than 20 years experience in electronic trading systems to his job. He was EVP of SunGard Systems, Inc, while he was with Automated Securities Clearance, Inc. Prior to that, he led a team that created a thing called BRASS, that became the industry standard trade-order management system for NASDAQ.

NASDAQ seems to have been in his history all along. Bob graduated from Iona College with a degree in English, but in getting his MBA at NYU several years ago, his Masters thesis was on the subject of the operation of The NASDAQ Stock Market.

So somewhere along the line, Bob, you were destined to hold your current position and we're just delighted you're here today. Thank you for being here.

Mr. BOB GREIFELD (President & CEO, NASDAQ): Thank you Ken. I'll take it as a compliment you said I got my MBA several years ago because maybe I'm younger than I look. It was several decades ago.

It's certainly my pleasure to be here today. I'll just vent with you a little bit of my frustration before I start. As you know, NASDAQ is a publicly held company. In the last 12 months our stock, has gone from \$6 to about \$29.

Now just this past weekend I was at a social gathering with friends, and they relate NASDAQ the stock market to the NASDAQ Index. They said 'Bob, you've had a relatively flat year. Can't you do anything about that?' I guess I'm fortunate in that my board of directors does understand the difference between our stock price and the NASDAQ Index.

But I bring this example up because I believe it points out the fact that NASDAQ, as an entity, is somewhat unique. And I think we are the very definition of the fact that good regulation means good business.

Now, our fundamental responsibility is to ensure that investors believe in the soundness of our markets. If they believe in the soundness of our markets then we'll have trading volume and then we'll have liquidity. And if we have liquidity we'll have listings.

Now, the opposite is also very true. If they do not believe in the soundness of our markets then the volume will dry up, the liquidity will dry up, and so will the listings. So truly, trust is the oxygen that makes this organization work. I believe that Refco really illustrates that companies built on trust can implode very, very quickly when that trust is lost.

If you look at the Refco situation, that \$400 million debt was repaid. Refco's business was in essentially the same shape before the announcement. But an organization built on trust can implode when your customers, participants and investors stop believing. So certainly, we recognize that is our job here at NASDAQ. Our very first job is to make sure we have the best trading platform and the best regulatory platform for investors.

Now second, working with our board of directors, we act in the interests of our shareholders. We also understand that if we pay attention to the first -- making sure that we are the best trading and regulatory platform -- the second, our shareholders, will come about as a by-product. What's very interesting is the inverse of that is not necessarily true.

At NASDAQ we are seen around the world as a unique American institution. Our brand is certainly a global brand and overseas it represents, American growth, entrepreneurship and innovation. In 1971, NASDAQ was formed. At that time every single market on the planet was a floor-based market. If we look globally, we see that the rest of the world has followed NASDAQ's electronic lead.

Now, we've been the beneficiary of that branding and of our market model. It's evidenced in the amount of international listings that come to market. This year we've had 13 international listings. Six of them have come from China, most notably Baidu, which is a stock that went up quite dramatically.

Now, here in the US we have seen a fundamental transformation of equity market trading and equity market listings in the time period from 2002. The year 2002 stands out as a watershed, one you're keenly aware of, and that is the passing of Sarbanes-Oxley. And that certainly had a dramatic impact.

The second, which you might not be as aware of, is that we had decimalization come to our markets in the 2002 timeframe. Now decimalization, what does that mean? We who live in the equity markets know it intimately. It's something of an inside baseball story.

The first part about decimalization is realizing that in the capital markets, we define efficiency by the narrowness of the spread. Now, what does a spread mean? A spread is essentially the difference between the buying and selling price for a stock at a given moment in time.

In the proper functioning of any market, you have professionals, professional intermediaries, whose job it is to provide continuous liquidity to the market.

So they will be a buyer and they'll then hope to be a seller and capture the spread in between.

Now, our industry has certainly had its share of issues as we transform into present-day standards. And one of them was the fact what we continued until 2002 to trade in Spanish pieces of eight, or fractions.

Now, why would the industry have kept trading in fractions? Well, if you're in fractions, then the spread, which is really your revenue line item, has to be expressed in either 25 cents, 12.5 cents, or 6.5 cents.

Now, when decimalization came and fractions went away, the trading profit margin, on average, went from about 12.5 cents down to one or two cents. So this change was not self-generated from the industry. It was somewhat imposed by Congress. Congress strongly pressured the commission.

Originally the industry attempted to implement decimalization in 1999. The industry successfully resisted it based upon, I believe, legitimate Y2K issues. But Congress came back and the industry had to move to decimalization.

So if you think of a business model that goes from 12.5 cents to one or two cents, you can imagine the fundamental changes that will happen.

Now, in the NASDAQ Marketplace, before decimalization, we had approximately 500 market makers. The market makers have a responsibility to provide continuous liquidity to the market. Post-decimalization, we stand here today trading roughly the same volume with about 200 market makers, so, this is a fundamental and dramatic change.

So what stepped up to replace that traditional market maker function that existed in the pre-decimalization era? What stepped up was electronics. The NASDAQ marketplace was, I think, uniquely positioned to take advantage of that. So we saw our market really transform from a principal-driven market to an agency-electronic-driven market, where more and more of the trading happened electronically.

Now, if you're a Microsoft in our market, post-decimalization, then you will trade most of your stock in essentially an electronic fashion. As you go down the market cap curve and the average daily trading volume curve, then there is a requirement to have intermediaries. They still provide value in our marketplace.

Now, the NASDAQ model is unique here in the states in that we recognize the value of intermediaries, but we also know that it's a love/hate relationship in that if that they are making profits than that's a theoretical extraction from the investors' returns.

So what we do in the NASDAQ marketplace is to ensure that we have all the sharks in the tank together, so any one stock will have multiple market makers or

intermediaries competing with each other. The wonderful thing about competition is that it tends to reveal the right answer.

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Now, on the other side, with our main competitor here in the states, the impact of decimalization has been dramatic. But their market structure was not in place to evolve in the new type of world.

If we recollect back to 213 years ago, clearly the folks setting up a market outside on Broad Street were not thinking about investor rights. And their structure was to have one intermediary, called a specialist, to be able to see and interact with all orders.

So there was a fundamental conflict of having one person serve as both a principal and an agent. This agent runs an auction to bring buyers and sellers together but also acts as principal for his or her trading account.

Now, in a pre-decimalization world, the value of the agency function of running an auction to narrow the fractional spread obscured that fundamental conflict. We see in the post-decimalization world that that conflict has been revealed. There have been very public and visible problems.

So we have a NASDAQ world that went through fundamental changes in decimalization. As a result of it, it was structured to evolve more and more of trading was done electronically. We see a competitor who has had some difficulty responding.

The other major point was Sarbanes-Oxley. Coming out of Enron and WorldCom, we had the SEC bring us and The NYSE together to work on common listing standards. So in the post-Sarbanes, post-Enron, post-WorldCom environment, you see the listing standards on the two markets being roughly identical.

Now, if we go forward from 2002 to 2005-2006, we see that the buy-side investors in the post decimalization world said that the market has to change. Primarily they meant our competitor.

The SEC passed in 2005 what's known as Reg NMS. It's due to be effective in mid-2006. And it essentially forces other markets to look and act like NASDAQ's, it forces markets to become electronic in order to remain competitive. If a market is not electronic, then investors have the right to essentially trade through these non-electronic markets.

Reg NMS also introduces a watershed concept. That is the separation of trading from the listing decision. So when you are listed on a market, it no longer means that you necessarily will trade on that market.

That behavior began at the time Reg NMS was passed. The market is not waiting for the implementation of Reg NMS. At NASDAQ we see in certain market under stress studies that NASDAQ will garner a larger share of trading in a stock under stress, despite the fact that it's not listed on our market.

We have two notable examples. One was Sears/Kmart, when the merger was announced. Traditionally, Sears has been listed on the other exchange. On that day we traded 44 percent of Sears' volume in an electronic fashion. This was one of the contributors in having them switch from their listing to the NASDAQ market.

The other one was Elan-Biogen, when they were both working on the MS drug. The results obviously were going horribly wrong. The news hit the market like a bombshell. We saw that 55 percent of Elan's business, which was listed on New York, came to NASDAQ that day. NASDAQ did all the trading for Biogen, which is listed on our market.

So in the post-decimalization world, one that is anticipating the upcoming SEC changes, that you will have a convergence of market models and convergence of governance.

What happens when you have convergence? Well, the next phase would be the products become commoditized.

Now, we as the managers of markets then say 'nobody truly likes to compete in a commodity marketplace, and do we break out of that?' From this competitive dynamic develops. Competitors must innovate to get out of the commodity cycle.

So we're predicting that the NYSE will start looking like NASDAQ. The markets will converge. We'll enter a period of commoditization and then we'll spring forward to innovate.

At NASDAQ we are preparing to innovate. We are quite proud of some of the actions we've taken. Innovation means redefining the space that we compete in. We looked at the listing decision and said 'we need to put more hard product attributes to the listing decision.'

Two moves we've made this year: one is we've acquired a large D&O insurance broker. NASDAQ is very comfortable and knows how to operate in an environment where serving customers could be perceived to be to our short-term economic detriment. It is in our DNA. It's in our DNA to operate in a pristine manner in a regulated environment.

So clearly, the insurance space is not as heavily regulated as the securities industry. But that could change in the years to come. And as a broker, it's our job to make sure the customer gets the best rate for that D&O insurance, irrespective of our financial desires.

This service has been widely accepted by our customers and we're now a top-five broker in that space. It obviously gives us another touch point with our customers. And you can see that becoming a more and more important part of our fundamental product offering to listed companies.

The second move we've made, and one we're particularly excited about, is in the research space. The existing research model for a large number of companies is essentially broken. The commissions that Wall Street can generate by providing research are not equal to the cost of that research because you have a fair number to a large number of customers that do not generate the required level of trading activity. The model is broken.

Our company CEOs have been saying 'Bob, what can you do to help us with research coverage? I would gladly pay.' The only research offering out there before we came along was research via a direct payment to the research provider. But that research provider had very little credibility and was perceived as nothing much more than a marketing brochure.

So our Independent Research Network is set up as a joint venture. It's between us and Reuters. The listed companies will pay a direct fee to that joint venture. That joint venture will have a network of independent research professionals who will then be assigned and write coverage on that company.

The structure of the joint venture really borrows from our listing and delisting process within NASDAQ, that is, outside the joint venture, there will be a research council, similar to our listings council, they will establish transparent standards for independence. The council will also establish the standards for scoring and judging the quality of the research coverage.

Quality Research coverage is a pressing need for companies who have gone public. About 50% of all public companies have two or fewer analysts. It's a situation where the demand greatly exceeds the supply and we are in a process of rolling this model out to the industry.

So, that's what we're doing to innovate. I said we're pre-supposing that there will be convergence and commoditization of equity trading, which will force this type of innovation.

Now, Reg NMS is probably as far as the regulators can go to force convergence leading to commoditization. Reg NMS says to any floor-based market that if you're not electronic, investors can move past you. But truly to get the full way there, where the markets are competing on a full and disclosed basis, competitive forces have to be the catalyst. Competitive forces have to move this thing forward.

I would submit to this audience here today that you are the catalyst to bring the competitive forces truly in line to the marketplace. Now, why should you care about this? You have a lot on your plate. Well one, with respect to what happens in trading, if there's not true competition between markets, there is an explicit cost difference. There is an explicit rent that a market shrouded in mystery can charge.

We charge Microsoft \$75,000 a year to list with us. Our competitor will charge GE \$500,000 a year. So you have a \$425,000 a year differential. And one thing is for

certain, that listing fee, that explicit listing fee, comes out every year. So, over a 10-year period of time, that's a substantial amount of money. Our rate was \$60,000. We raised it to \$75,000, the competitor is at half a million.
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So with a market shrouded in mystery, you have an inefficient pricing mechanism. I come from primarily a technology background, where every dollar made a difference and we had to compete on it. So I'm mystified by this lack of transparency.

The second and the most important is the implicit cost of trading inefficiency. To the extent that you have inefficiency, to the extent that the spread is wired on a market where one person is in control as compared to a market where many sharks are competing against each other, you notice that pennies will matter. So when you can have a one cent spread differential that's one cent per share.

Why does that matter? Well, in most companies it matters somewhere between \$2 million and \$10 million per year. What does that mean? It doesn't show up directly on your income statement but it is a wealth-transference between your investors, your shareholders and the market intermediaries.

What we see here today is a competition between markets that is more akin to choosing the club of your choice, the country club of your choice. Companies choose to come to NASDAQ because they want to represent growth and entrepreneurship. Companies choose to stay or go to the other market because they want to be seen as part of the old-line establishment.

Let us recollect that our fundamental job is to make sure that we're providing the best trading environment for investors and the best regulatory infrastructure for investors. Our job is not to work on making sure that we are the club of choice for corporate management or the board of directors. Our job should not be a Coke versus Pepsi branding environment.

Now, as I say this I stand here in front of you probably as guilty as anyone, in that NASDAQ was the first market to run a TV commercial. NASDAQ has been widely lauded for its visionary series of television commercials. So clearly, we have been aiding and abetting this branding issue.

The fundamental issue in a listing decision is one of six degrees of separation. The pure consumer of the services NASDAQ brings to market is the buy-side trader. The buy-side trader has no decision-making power at all in terms of where the listing should be. The buy-side trader is the person that gets a half-a-million share order and who then has to work that in the market.

You go from the buy-side trader to the buy-side portfolio manager, who may or may not understand how markets truly operate. As we did our secondary offering in January of this year, I was certainly shocked at how little buy-side portfolio managers actually know about the operation of the market.

From there, you cross over to the investor relations person; from there, the CFO; from there, the CEO; from there the board of directors; and from there, possibly the private equity firms or the venture capital firms.

Each time you separate yourself from that pure consumer of the service, you have a possibility of lack of focus on the core issues. You also have a possibility of perversity of decision making criteria, which can result in things such as using branding as a key metric.

I know that you folks here who work on a board of directors have not been given any additional responsibility or any additional work over the last several years. That's true, right?

So I'm here with the popular message that we believe there should be one more item on your to-do list, just one more. That item is you should hold management accountable for how and why they're making a listing decision.

Now, management, in addition to saying a listing is an implicit branding decision -- an implicit choosing of a club -- have also commonly treated the listing like a state of being. They are listed on one market and they stay with that market for their entire life.

Now, it is our contention that listing decisions should be evaluated every year or possibly every two years. Clearly, every time you're watching a presidential debate or renewing your car lease, it's probably time to make sure that you are choosing the right market for the right reasons.

Now, we say this to all our 3,300 NASDAQ listed companies as well as saying it to an audience like we have here today. To the extent we do we'll be treating our investors more properly.

So, one more thing to do, we agree? No one's smiling yet. We'll get there. In conclusion, what we're saying is that we fundamentally recognize that our business is built on trust. Our business is about good regulation translating into good business.

Around the world NASDAQ is recognized as a wonderful and unique American institution. As I travel on a global basis, our brand name actually exports in somewhat a larger way overseas than it actually does here in the states. We see the world markets have followed our lead. They are electronic.

Thank you.