

COUNCIL OF INSTITUTIONAL INVESTORS

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May 11, 2006

Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: SR-NSX-2006-03

Dear Ms. Morris:

The Council of Institutional Investors has long advocated the separation of exchanges' regulatory and business functions. The Council, an organization of more than 300 investment professionals, including more than 130 public, corporate and union pension funds with more than \$3 trillion in investments, believes an exchange faces an inherent and untenable conflict of interest when it is responsible not only for running an efficient and effective marketplace but also for regulating its customers and protecting the investing public.

This position is at odds with the National Stock Exchange's (NSX) proposal to continue to run the exchange and exercise self-regulatory responsibilities over its members while becoming a direct, for-profit and wholly-owned subsidiary of a new Delaware for-profit stock holding company, NSX Holdings.

Conflicts of interest can arise when a business is also charged with regulating its owners and its customers. These potential conflicts only deepen when an exchange is a for-profit entity.

To address these potential conflicts, the Council recommends:

- Any regulatory operation should be independent of the exchange(s) and adequately funded; and
- Listing standard requirements should be a regulatory, rather than an exchange, responsibility.

Regulatory arms should be independent and adequately funded

Combining exchange and regulatory functions puts the regulatory arm in the difficult position of overseeing the primary customers of the exchange. Such combinations have not worked in the past. For example, a Nov. 3, 2003, Wall Street Journal article reported that a confidential Commission report of the New York Stock Exchange "paints a picture of a floor-trading system riddled with abuses, with firms routinely placing their own

trades ahead of those by customers—and an in-house regulator either ill-equipped or too worried about increasing its workload to care.”

The Council believes that for regulatory arms to be functional and effective they must be independent of exchanges and have mechanisms in place to ensure secure and full funding.

Listing standards should be a regulatory responsibility

Exchange listing rules are an important element in the total system of legal protections on which investors rely. Given their importance, the Council believes listing standards should be the responsibility of the independent regulatory arms, and processes should be in place to ensure that listing standards are kept up-to-date.

Housing the listing standard requirements with the business side of exchanges may harm the investing public by promoting: (1) a race to the bottom, with exchanges competing for listings by watering down their standards; (2) standoffs when it comes to updating outdated requirements; and (3) a reluctance to enforce standards when pressured by listed companies. Under NSX’s demutualization plan, responsibility for listing and delisting decisions and standards would rest with committees of the for-profit NSX’s board.

With Commission approval, NSX will be the latest exchange to join the demutualization trend. Since 2000, the Nasdaq Stock Market, the Chicago Board of Trade, the Chicago Mercantile Exchange, the International Securities Exchange and the Philadelphia Stock Exchange all have demutualized. Most recently, the New York Stock Exchange merged with Archipelago Holdings, demutualized, and went public in March 2006.

With exchanges switching to for-profit models, the Council urges the Commission to bolster the integrity of the U.S. equities markets and the protections provided to investors by acting on the above recommendations. A critical component of market effectiveness and success is investor confidence. Part of that confidence comes from knowing that adequate rules and other safeguards are in place to protect investors. Unfortunately, lapses in exchange self regulation over the years—including failures to adequately oversee specialists, enforce rules and maintain up-to-date listing requirements—have harmed investors and shown that the self-regulatory model is in need of reform.

The Council appreciates the opportunity to comment.

Sincerely,

A handwritten signature in blue ink that reads "Ann Yerger".

Ann Yerger
Executive Director