

March 9, 2005

Mr. Jonathan G. Katz  
Secretary  
U.S. Securities and Exchange Commission  
450 5<sup>th</sup> Street, NW  
Washington, D.C. 20549-0609

Re: Concept Release on Self-Regulation  
Release No. 34-50700; File No. S7-40-04

Dear Mr. Katz:

Philadelphia Stock Exchange, Inc. (“Phlx” or the “Exchange”) welcomes the opportunity to offer its comments to the Securities and Exchange Commission (“SEC” or “Commission”) on the above-referenced concept release (“Concept Release”).<sup>1</sup> In the Concept Release the Commission noted that changes in the markets and in the ownership structure of self-regulatory organizations (“SROs”), increased dispersion of order flow across multiple markets, increased competition among markets for listings and trading volume, and the advent of for-profit, shareholder-owned SROs in recent years has raised issues relating to the adequacy of the current system of industry self-regulation. Among other things, the Concept Release examines and seeks comment on certain enhancements to the current system of industry self-regulation and a number of alternative regulatory approaches or legislative initiatives that could be considered by the Commission to address concerns with the current SRO model.

The Concept Release acknowledges that certain alterations of the current regulatory model could have the negative effect of reducing market specific knowledge on the part of regulatory staff by removing it from market operations. Any non-market specific regulator would likely lack critical market specific expertise. Additionally, sources of funding for any new regulatory scheme would raise significant and potentially controversial issues and, as noted in the Concept Release, could require Congressional action. The Exchange thus believes that of the various alternative regulatory approaches presented in the release, the first and most modest approach is preferable. Essentially, this approach would adopt certain incremental enhancements proposed in the pending

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<sup>1</sup> Securities Exchange Act Release No. 50700 (November 18, 2004), 69 FR 71256 (December 8, 2004).

SRO Governance and Transparency Rulemaking (the “SRO Governance Rulemaking”)<sup>2</sup> and provide for the development of a more robust intermarket order audit trail, but otherwise would maintain the self-regulatory structure as currently configured. As the Commission noted in the Concept Release, in 1975 Congress stated that although the SROs had not always performed their role up to expectations, self-regulation generally was considered to have worked well and “should be preserved and strengthened.”<sup>3</sup> The Exchange agrees with the Commission that it is generally considered that the SRO system has functioned effectively and has served government, industry, and investors well. The Exchange does not believe that the various industry changes identified in the Concept Release are extensive enough to require substantial and in some respects untried changes to the current system of industry self-regulation.

As the Exchange has stated in the past<sup>4</sup>, each market center utilizes diverse methods, and employs different technologies to attain the required level of surveillance, compliance, and enforcement policies and procedures to meet the standards set by the Securities Exchange Act of 1934 (the “Act”) as implemented and interpreted by the Division of Market Regulation and the Office of Compliance Inspections and Examinations (“OCIE”). OCIE’s routine oversight inspections evaluate the adequacy of SRO regulatory programs, the competence of SRO staff, and the SRO’s own compliance with their own rules and those of the Act. OCIE is in a position to make a determination regarding shortcomings in and inequality between and among markets, which in the Exchange’s opinion, OCIE does on a routine basis. As stated in our comment letter on the pending SRO Governance Rulemaking, we believe that too total a divorce of regulatory from market functions would result in the outcome that our entire system of self-regulation was designed to avoid: regulation that is not well informed by market knowledge.

Our comment letter on the SRO Governance Rulemaking separately sets forth our views on the various specific proposed transparency and independence proposals. Generally, we believe that many of the rules proposed in the SRO Governance Rulemaking will enhance public understanding of, and confidence in, our markets. However, we believe that a number of the elements of those proposed rules would be somewhat burdensome, and that substantially the same benefits may be achieved by alternative means. Finally, as we noted in our comment letter on the SRO Governance Rulemaking, the proposals it presents are extremely important, and the Phlx will do what is necessary to comply, in whatever time frame is incorporated into the final rules.

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<sup>2</sup> Securities Exchange Act Release No. 50699 (November 18, 2004), 69 FR 71126 (December 8, 2004).

<sup>3</sup> Concept Release on Self-Regulation, Section II – Foundations of Self Regulation (citing S. Rep. No. 94-75, 94th Cong., 1st Sess. 7, II (1975).)

<sup>4</sup> See letter to Jonathan Katz, Secretary, Commission, from Meyer S. Frucher, Chairman and Chief Executive Officer, Phlx, dated June 17, 2003 (commenting on Release No. 34-47849, File No. S7-11-03, Request for Comment on Nasdaq Petition Relating to Regulation of Nasdaq-Listed Securities).

However, we reiterate that we believe that it is not necessary to the fulfillment of the Commission's regulatory and policy objectives to force these changes to completion in an unrealistically short time frame.

As for the enhancements to intermarket surveillance, we have stated in the past that an open and robust discussion on the development of an intermarket consolidated order audit trail system for Nasdaq-listed and exchange-listed securities (other than options that are subject to COATS requirements) has merit.<sup>5</sup> However, care must be taken to ensure that such costs and burdens are considered in the development of the system to ensure that the regulatory value of the specific information captured by the system (and the means employed to capture it) justifies the considerable costs and burdens on exchanges and members in implementing such a system.

Although not one of the models set forth in the Concept Release, we believe that the Commission and the industry should consider the development of a voluntary Regulatory Cooperative that would be jointly owned by the participating exchanges. The Regulatory Cooperative would be the central regulator for market surveillance functions, examinations and investigations. It would provide a centralized hub for market surveillance technology and associated functions and tools. It would link on-floor surveillance needs with the regulatory hub and would also have an electronic interface to the SEC. Common reviews (such as those for insider trading, front running, and market manipulation) would need only be developed once and not individually for each exchange, and could be executed and supported on a centralized database at the Cooperative's hub. Shared resources would save each participant from duplicating required infrastructure. Substantial savings to the industry, which would ultimately benefit investors, could result from the implementation of such a Cooperative. The Phlx would be pleased to share its ideas concerning the potential efficiencies and savings to be obtained through a Regulatory Cooperative with the Commission and its staff in greater detail.

Finally, the Concept Release discussed issues relating to SRO funding, identifying the five primary sources of SRO funding as regulatory fees, transaction fees, listing fees, market data fees, and other miscellaneous fees. The Concept Release focused in particular on the issue of market data fees, noting that revenue from such fees has traditionally been a very important component of SRO funding and that market data is also critical to market participants and investors.

The Exchange has previously urged the Commission to proceed cautiously with reforms in the area of market data fees, noting that Commission requirements applicable to SROs and industry utilities (such as those concerning surveillance, systems capacity and integrity, and regulatory oversight) impose a heavy burden and very significant

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<sup>5</sup> Id.

costs.<sup>6</sup> The Exchange continues to believe that market data fees are a critical component of an adequate system for recoupment of these costs. Market data fee revenue received by the Phlx is not designated by the Exchange for any specific purpose, but is integral to the Exchange's ability to operate. This data is readily available to investors today and the Exchange believes that market forces are already at work in establishing fair and reasonable fees for market data. The Exchange believes that absent truly compelling reasons, the existing model with respect to market data fees should remain as it is today.

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We appreciate the Commission's consideration of our comments. If the Commission or its Staff should have any questions regarding the matters discussed above, please contact Edith Hallahan, Senior Vice President and Deputy General Counsel, at (215) 496-5179, or Carla Behnfeldt, Director, Legal Department New Product Development Group, at (215) 496-5208.

Respectfully submitted,

Meyer S. Frucher  
Chairman and Chief Executive Officer

cc: The Honorable William H. Donaldson, Chairman  
The Honorable Paul S. Atkins, Commissioner  
The Honorable Roel C. Campos, Commissioner  
The Honorable Cynthia A. Glassman, Commissioner  
The Honorable Harvey J. Goldschmid, Commissioner  
Annette Nazareth, Director, Division of Market Regulation  
Robert Colby, Deputy Director, Division of Marker Regulation  
Elizabeth King, Associate Director, Division of Market Regulation

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<sup>6</sup> See letter to Jonathan Katz, Secretary, Commission, from Meyer S. Frucher, Chairman and Chief Executive Officer, Phlx, dated April 6, 2000 (commenting on Release No. 34-42208, File No. S7-28-99, concerning the regulation of market data fees.)

