

Archipelago Exchange  
Boston Stock Exchange  
Chicago Stock Exchange  
International Securities Exchange  
Nasdaq Stock Market  
Philadelphia Stock Exchange

Jonathan G. Katz  
Secretary  
Securities and Exchange Commission  
450 Fifth Street, NW  
Washington, DC 20549-0609

Re: File No. S7-39-04 -- Fair Administration Release ("FAR")  
File No. S7-40-04 -- Concept Release ("CR")

Dear Mr. Katz:

The Archipelago Exchange, the Boston Stock Exchange, the Chicago Stock Exchange, the International Securities Exchange, the Nasdaq Stock Market, the Philadelphia Stock Exchange (collectively, the "Markets") appreciate the opportunity to submit comments on the FAR and CR.<sup>1</sup> The Markets commend the Securities and Exchange Commission (the "Commission" or the "SEC") for its thoughtful consideration of the self-regulatory system, which has served investors well for many years.

The Markets recognize the special roles and responsibilities that marketplace self-regulatory organizations ("SROs") have in the U.S. economy. Each Market helps ensure that U.S. financial markets are the most respected in the world and that each Market has the special duty to ensure the integrity of its respective market for the benefit of investors and issuers and others participating in the U.S. markets. Each Market also recognizes its responsibilities to enforce its members' compliance with its own rules as well as with the Securities Exchange Act of 1934 ("1934 Act") and the Commission's rules. The Markets accept these special roles with the utmost seriousness. The Markets recognize the great responsibility placed on the Commission in an era of fast-paced changes in the nature, scope, and importance of the financial markets and, therefore, fully appreciate the Commission's efforts. As a result, the Markets

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<sup>1</sup> The Markets note that the comments in this letter are in addition to comments each Market may provide separately. In their separate comments, each Market may focus on certain aspects of the FAR and CR that are particularly relevant or of particular importance to that Market.

support the Commission's efforts to ensure that SROs have effective compliance programs that are consistent with their self-regulatory responsibilities.

The Markets commend the Commission for its willingness to accommodate a changing business environment by, among other things, allowing SROs to de-mutualize, to offer shares to the public, and to provide for innovative regulatory arrangements. The Commission's willingness to embrace change and to work with the Markets, other SROs, and other interested parties, is key to keeping U.S. markets competitive and providing the most liquid, deep, and fair trading environments for investors. Further, the Markets agree that the changing environment calls upon the Markets to review their structure and operations and to make such changes as are appropriate.

### Concerns

It is in this context that the Markets respectfully wish to make the following comments about the FAR and the CR. The Markets appreciate the need for the Commission to set basic standards for all SROs. Nonetheless, the Markets believe that the specific standards contemplated in the FAR are too rigid and impose a "one-size-fits-all" approach on the SROs. In particular, the Markets believe:

- **FAR Definition of "Independent Director" and SRO Board Requirements** – The Markets support independence in general and agree that within any corporate structure, including an SRO, independent directors bring objectivity and can help ensure integrity. We also believe that boards should be composed to ensure that the SROs receive significant input from directors who have no relationship to members or issuers. Nonetheless, we believe that all marketplaces, subject to the Commission's oversight, should have greater flexibility to develop their own approaches to independence, based upon a definition that focuses on materiality of a director's relationship to the Market, and board composition than the FAR would permit. We believe the Commission should not force the Markets to dismiss talented board members who are able to offer great experience either from the securities industry or from the listed community.
- **Committee Structure** – The Markets recognize the benefits of including independent board members on various board committees. However, as a result of the potential loss of flexibility, we disagree with the mandated requirement for specific committees composed exclusively of directors that meet the FAR's proposed definition of independence. The Markets believe that they should have flexibility to determine the composition of their committees, subject to the appropriate representation of independent directors. We note that certain Markets currently anticipate that selected committees will be composed only of independent directors, but based upon a definition of independence that focuses on the materiality of a director's relationship to the Market. The Markets believe that the proposed requirements would be inflexible and fail to recognize the

differences among the Markets and other SROs. The imposition of an independence requirement for all members of all standing committees could significantly diminish the benefits of self-regulation with respect to those committees by eliminating the roles of issuers and members of the SRO.

- **Regulatory Structure** – The Markets recognize the need to minimize conflicts of interest. However, imposing an identical regulatory apparatus on all SROs would not accommodate differences among the marketplaces, and indeed, could be counterproductive. In addition, the Markets are concerned that the proposed regulatory structure could add to the complexity of management by reducing the ability of a Market to make certain that its personnel are appropriately accountable for their actions. In particular, the Markets are concerned that:
  - Certification -- It would be difficult for the chief executive officer to make the certifications contemplated in Proposed Rule 17a-26(c) when the regulatory program would be subject to a completely independent management and reporting structure.
  - Financial Management -- It would be difficult for the chief executive officer of the SRO to manage the SRO's financial affairs without a complete picture of the regulatory function, budgets, and personnel.
  - State Corporate Law -- The Commission is proposing a corporate structure that may be difficult to reconcile with state corporation laws.
- **Efficient Use of Compliance Resources** – The Markets fully recognize the benefits of disclosure to the SEC. However, the Markets question whether the imposition of the reporting and other compliance requirements proposed in the FAR would exceed the benefits that might be achieved. The Markets believe that the proposals fail to recognize existing, effective reporting mechanisms.

The Markets appreciate that there are costs associated with maintaining the Markets' regulatory systems and there is a need to provide useful information to the Commission in conjunction with its oversight responsibilities. But we also note that the costs of regulation may ultimately be borne by investors; the Markets believe the cost of these proposals may be excessive and that there are more effective means for achieving the benefits that the Commission and the Markets seek.

In short, the Markets believe that the FAR would reduce the flexibility of each Market to address issues that it confronts today and that could arise in the future. The FAR significantly alters the balance between governmental regulation and self-regulation. It would diminish the Markets' contact with the realities of the capital markets, with few offsetting benefits. The types of changes mandated by the FAR seem to be different in kind from the self-regulatory system that Congress envisioned when it enacted the 1934 Act, the Maloney Act of 1938, and the

Securities Acts Amendments of 1975. The Markets respectfully request that the Commission carefully considers whether this approach really would benefit the investing public and issuers.

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The Markets all strongly believe that self-regulation is in the best interests of investors, issuers, and our economy; we strongly urge the Commission to reassess its proposed action before adopting final rules. We look forward to working with the Commission and the Staff to resolve these issues in the best interests of investors.

Sincerely yours,

Archipelago Exchange  
Boston Stock Exchange  
Chicago Stock Exchange  
International Securities Exchange  
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