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March 8, 2005

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

Re: File No. S7-39-04
Fair Administration and Governance of SROs

Dear Mr. Katz:

This letter is for the purpose of providing several comments on the above-captioned proposal ("Proposal"), which attempts to improve the governance of SROs and enhance their regulatory effectiveness for the protection of the investing public. The Proposal covers a wide variety of important governance issues, and the SEC's extension of the comment period was an important step in ensuring that as many comments as possible are received so that the SEC can achieve final rules that are fair, balanced, and reasonable—rules that do not make SRO governance so burdensome that smaller SROs lose their ability to compete. Accordingly, the following comments are being submitted solely as personal opinions.

Generally, the SEC is to be commended for initiating the Proposal as it is the next logical step in ensuring that SROs are governed as appropriately as the public companies that are listed on them. While public company governance is of course critical to the investing public, the proper governance of SRO regulatory processes is the foundation upon which the reputation of our securities markets rest. Without the assurance that the public investor is completely protected at each step of the transaction process, our markets can lose their credibility, especially in this era of globalization and cross-border trading.

Many of the specific initiatives in the Proposal are traceable to the natural evolution of our securities markets, and it should not be forgotten that the SROs have been the SEC's partner in improving SRO governance and the oversight of regulatory processes. Indeed, some of the smaller SROs have been at the forefront of this effort over the last twenty years, and in that regard, full cooperation and collaboration between the SROs and the

SEC should be the order of the day, not the adversarial relationship that seems to be the current situation. While there have been a number of systemic regulatory failures in the last several years (failures that have received considerable media attention), the SEC has more to gain by partnering with the SROs in achieving the mutual regulatory mission—the protection of the investing public.

Specifically, I want to provide some comment on the composition of the SRO board and the regulatory oversight committee. Regarding the composition of the board, it is clear that independent directors play a critical role in bringing objectivity to the table, and they help reduce the possibility of conflicts of interest, which can contaminate the deliberations of the board. However, the issue of whether 80% of a board should be comprised of independent directors is unclear. When the move toward greater numbers of independent directors on SRO boards was first initiated by the SEC in the 1990s under the chairmanship of Arthur Levitt, Jr., there was a concern that a proper balance should exist so that a board would maintain essential industry expertise to facilitate informed decision making.

In the running of an SRO, a wide variety of specialized expertise is required, including floor trading, electronic trading, regulatory processes, and broker-dealer functions. Traditionally, industry directors have had the necessary expertise to wade through these and other specialized areas. And while independent directors are expected to endure a steep learning curve after joining a board, an in-depth understanding of the marketplace in general and the functions of the SRO in particular may take many years to achieve, or may never be achieved. As a result, the industry directors may become heavily relied upon for background and indeed direction during board deliberations. In this way, it is possible for industry directors to in effect have more influence in decision making than is intended by the strict percentage composition in the Proposal. As it doesn't appear that this issue has been raised previously, and although the general concept of an independent director composition threshold is desirable, it is mentioned here as something to be mindful of.

With regard to the regulatory oversight committee ("ROC"), the independent oversight of regulatory processes by a body that is not influenced by business considerations is of course a critical element in the proper functioning of the processes that enforce rules and directly protect public investors. However, as noted above in the comments regarding the board, the ROC in particular must have a minimum level of industry expertise. In some ways this industry expertise at the regulatory oversight level is even more important than at the board level. First, the ROC must be able to understand surveillance processes and the nuances of rule interpretation. Second, the ROC must have a clear understanding of the disciplinary program and an unequivocal grasp of due process. Such expertise at the oversight level is essential to the ROC's mission of ensuring that the regulatory program is doing what it is supposed to be doing.

A properly functioning regulatory program not only protects the interests of the investing public, but it provides for the fair and equitable treatment of members and member firms who happen to be involved in the disciplinary process. Due process in particular is an

important component of an SRO's obligations under Section 6 of the Securities Exchange Act of 1934, and such due process guarantees that a member or member firm will have the ability to defend itself on an equitable basis. Consequently, it is vital that the composition of the ROC reflects a solid grounding in these areas. Therefore, a strict percentage of independent directors on the ROC is less important than the expertise that is necessary to carry out its mission. As noted above with regard to the board composition, it may be that industry directors will be relied upon too heavily during the ROC's deliberations. In the event that industry directors on the ROC are minimal, then there have to be assurances that the independent directors have an adequate understanding of the processes they are overseeing.

Thank you for the opportunity to comment on the Proposal, and although there are many important issues in the Proposal that could prompt comment, I hope my comments on just a few areas of the Proposal will be helpful. If you have any questions or comments, please do not hesitate to contact me at (949) 366-2560.

Sincerely,

David P. Semak