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Via e-mail to www.rule-comments@sec.gov

March 8, 2005

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

Re: Securities and Exchange Commission Release No. 34-50699, File No. S7-39-04
Request for Comment on Proposed Rules on Fair Administration and Governance
Of Self-Regulatory Organizations

Dear Mr. Katz:

The New York Stock Exchange (the "NYSE" or the "Exchange") is pleased to comment on the Securities and Exchange Commission's (the "Commission") initiatives reflected in the Proposed Rules on Fair Administration of Governance of Self-Regulatory Organization ("Rules Proposal"), principally with respect to Governance, Separation of Regulatory from Market Operations, Confidentiality of Regulatory Information, and Financial Disclosure. The Proposed Rules would codify many of the governance and transparency structures that the NYSE has already put in place and is convinced are beneficial for the NYSE, investors and the national market system. Similarly, the periodic reporting requirements encompass the type of regulatory reporting that NYSE Regulation has long provided to the Commission on a regular basis during oversight examinations and regularly uses to manage and plan its regulatory program. With respect to the very detailed questions and requirements, the NYSE is also submitting two separate appendices (Appendices A and B) providing detailed answers, examples, and observations. We look forward to engaging with the Commission staff to clarify specific reporting formats and definitions.

Governance

The NYSE has completed over the past 18 months an intensive self-evaluation of its governance and transparency, much of it in the public eye and subject to intense scrutiny of market participants and the Commission. The new governance procedures and structure of the NYSE, approved by the Commission following the approval of changes to the underlying Constitution of the NYSE by its members, have been effective. These governance requirements meet – and in many aspects exceed – the proposed standards of fair representation of member and governance of self-regulatory organizations ("SROs"). The NYSE does have a concern that a few of the proposed standards are over-broad or may have unintended consequences, and we have specified our concerns and suggestions in Appendix A. More importantly, the NYSE's experience demonstrates that the functional separation model currently in place does successfully diminish potential conflicts of interest between business demands and regulatory obligations.

Separation of Regulatory from Market Operations

As an important part of the reform process of 2003, the NYSE formalized the effective functional separation of regulatory programs from the competitive business functions, under a Chief Regulatory Officer ("CRO") reporting to a Regulatory Oversight Committee ("ROC") of the Board of Directors consisting of all independent directors, with full authority to set budget and staffing levels, including the technology budget that supports the regulatory program. We agree with the Commission that this structure, with a separate regulatory executive reporting to an empowered, qualified and independent board, amply funded and professionally staffed, assures the integrity of the regulatory process. When this new structure and functional separation were put in place, the NYSE earmarked all regulatory fees, fines, and penalties for regulatory operations and put in place financial controls and reporting to that effect.

The present architecture of the NYSE is intended to functionally, but not physically, separate the regulatory aspects of the NYSE from its marketplace and listed company operations. Headed by a CRO reporting to an empowered special standing committee of the Board, Regulation encompasses market surveillance, member firm regulation, enforcement, arbitration, and listing compliance. Thus, although certain common administrative areas are shared, regulation is enabled to operate free of ostensible conflicts which may arise from other institutional aspects of the Exchange. The integrity of this process is safeguarded by the constitutional underpinnings of the described structure, the independence of the NYSE Board of Directors, the authority vested in the ROC of the Board, by the NYSE Directors' Code of Business Conduct and Ethics, and the Officers' and Employees Statement of Business Conduct and Ethics. The NYSE is proud of this structure and views it as an evolving process readily adaptable to ameliorate internal and external stress and environmental change.

Confidentiality of Regulatory Information

The proposed requirement that "regulatory information" be safeguarded and used only for the purpose of carrying out regulatory functions is consistent with present NYSE

practice. Not infrequently, for reasons of effectiveness, the regulatory function requires communication with non-regulatory personnel, examples of which are discussed in more detail in Appendix B. The NYSE, as noted, is committed to assuring the integrity of the regulatory process and the independence of regulation. It agrees that source-identifiable regulatory information reasonably expected by its providers to be treated confidentially should be treated as such, and that similar regulatory information (including enforcement, surveillance, and examination specifics) should not be utilized for purposes not in support of regulatory activities. As currently structured, approvals for regulatory action, decision-making or expenditures are neither required nor sought from the non-regulatory side of the NYSE.

Independence does not and should not equate to a virtual blackout of information between and among the various departments of the NYSE. In our view, the thrust of the proposed rules should be to safeguard that regulatory information is used to fulfill regulatory purposes. It should not prevent the dissemination to non-regulatory staff when communication is necessary to achieve legitimate regulatory goals.

In this connection, the proposed definition of "regulatory information" is overly broad. Examples discussed in detail in the Appendix B include various types of information, including market information, regularly collected or filed by firms pursuant to standing rule requirements or filing protocols. These categories are distinguishable from types of information received in the course of reviewing complaints, investigations or during disciplinary hearings which are and should be guarded as confidential and not shared with the non-regulatory departments until proceedings have been concluded or information must be made public for the protection of investors or to avoid disruption to the public trading of securities.

Another important and approved process for the sharing of regulatory information involves the entire corporate governance and financial compliance functions in fulfillment of listed company compliance. Within the new regulatory structure, these departments perform the essential evaluative process of certifying whether prospective listed companies meet original listing standards and maintain continued listings and corporate governance requirements. In these areas, there is cooperative gathering of information and sharing of information, with well-established procedures to protect confidentiality and the deliberative process. Rules that prevent the necessary sharing of information between regulation and business staff in this area would undermine the listings standards and process approved by the Commission – clearly an unintended consequence which revisions of the proposed rules can and should avoid. An absolute bar on information disclosure would undermine the effectiveness of regulation and is not required.

Financial Disclosure

Although not a public company, the NYSE publishes an annual report with detailed financial disclosure including a consolidated statement of income and balance

sheet, which are certified by an independent and accredited auditor. The NYSE supports disclosure that fairly describes its sources of revenue and expenditures, particularly with respect to the extent of its commitment to regulation. The NYSE supports a transparent financial disclosure process that is efficient, comparable to public company disclosure standards, and comprehensive, but has some technical comments with respect to the timing for periodic reporting, the level of detail of certain revenue and expense categories, and certain reporting thresholds. These are set out in Appendix A. Disclosure requirements should not be so detailed as to have the effect of placing the NYSE at a competitive disadvantage with respect to competitors in related businesses that are not SROs, and therefore not bound by the same requirements.

We welcome the opportunity to discuss any aspect of the Rules Proposal with the staff of the Commission. If you have any questions, please call Linda Rich, Government Relations, at (212) 656-8749 or (202) 661-8979, James F. Duffy, Office of General Counsel, at (212) 656-5855, Regina C. Mysliwiec, Regulation, at (212) 656-4831, or the undersigned at (212) 656-2062.

Sincerely,

cc: Chairman William Donaldson
Commissioner Paul Atkins
Commissioner Roel Campos
Commissioner Cynthia Glassman
Commissioner Harvey Goldschmid
Ms. Annette Nazareth
Mr. Robert L.D. Colby
Mr. David Shillman
Ms. Nancy J. Sanow

SEC SRO RULES PROPOSAL RELEASE NO. 34-50699
BUSINESS APPENDIX A

I.

Fair Administration and Governance

A. Governance Guidelines

The NYSE notes that much of what the Commission has proposed with respect to SRO governance incorporates the elements of the NYSE's current governance structure approved by the Commission in November 2003, although the NYSE has gone farther in certain respects than the Commission will require of all SROs. Most notable in this respect is the fact that the NYSE requires that all its elected directors be independent, in contrast to the Commission's proposed requirement that each SRO have a majority independent board.

As a result, the NYSE generally supports of the proposal, since it has found its own independent board to have significant advantages over its previous governance arrangements. However, the NYSE has now had the advantage of more than a year's experience with its new governance scheme and with its board independence policy, as well as with the similar policy imposed on Exchange-listed companies. This experience has given us some insight into these policies that we think the Commission will find relevant. It also gives us insight into difficulties that may be attendant to the ways in which the proposed rules go beyond the independence requirements that are part of the NYSE's new governance approach.

The NYSE has two main areas of concern with the proposals. One is what we would consider the over-broad restrictions regarding service on the audit committee and regarding relationships with listed companies. (We will also note for the Commission's consideration two additional features of the NYSE's independence policy that the proposals do not incorporate.). The second concern involves the way the proposals articulate the independence tests, which have been adapted from those currently imposed by SROs on listed companies. NYSE and Nasdaq articulate their listed company standards in slightly different ways. The Commission's proposals tend to mix and match from among the NYSE and Nasdaq rules. We think this approach is unnecessary, and potentially confusing for all concerned. In addition, the NYSE would find it awkward to administer its own version of a rule vis-à-vis its listed companies, while having to comply with a Nasdaq version of the same rule itself. A better approach would be to require each SRO to apply its own listed company standards to its own board, as the NYSE has done over this last year.

We will elaborate on each of these concerns.[1]

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[1] Our comments in Sections A and B of this Appendix are responsive to Questions 1, 5 and 6.

B. Composition, Structure and Responsibilities of the Board and Board Committees

Restrictions on Audit Committee Service

In adopting the provisions of Rule 10A-3 of the Securities Exchange Act of 1934 (the "Exchange Act") for purposes of the Commission's proposal on the independence standard applicable to directors serving on the SRO's audit committee, the Commission has elected to treat compensation from an Exchange member as the equivalent of compensation from the Exchange. We believe that this approach is too severe, and will inappropriately narrow the field of audit committee candidates. We are concerned that the real difficulty will come with respect to any individual in the legal or accounting profession. Under Rule 10A-3, indirect compensation includes that paid to a firm in which a director is a partner, and the result here will be to largely preclude from audit committee service anyone who is a partner in a law or accounting or other financial services firm that has a client that is an Exchange member. And the fact that there is no *de minimis* level means that it does not even have to be a significant client of the firm. As a practical matter, we expect this would preclude from audit committee service all partners in the major accounting firms, and all partners in many of the major law firms as well.

We suggest that it is not necessary to go this far, especially in view of the crucial need to obtain suitably experienced directors to undertake the increasingly demanding role of a member of the audit committee. We suggest instead that the standard in this regard simply mimic the requirements of Rule 10A-3 as applied to listed companies, and focus on whether the director has received direct or indirect compensation from the SRO, without extending the concept to compensation from members of the SRO.[2]

Restrictions on Family Members or Prior Affiliation with a Listed Company.

In establishing the independence standards for its own board, the NYSE was mindful that the relationship between the NYSE and its listed companies is different from the relationship between the NYSE and its members. While the NYSE is the primary securities self-regulator for its members and member organizations, it plays a regulatory role only with respect to the listing standards that it requires listed companies to comply with as a condition of their listing or continued listing on the NYSE. It is much less closely involved with the business of its listed companies than it is with the business of its members and member organizations. This alone supports a different approach to relationships between NYSE directors and NYSE listed companies. As a result, the NYSE's current standards preclude independence for a director who is an executive officer of an issuer of securities listed on the Exchange. But the NYSE did not extend that proscription to a director with an immediate family member who is an executive officer of a listed company. Nor did the NYSE extend the three-year "look-back" to this

[2] Note that the general independence standard still applies, precluding independence (and hence audit committee service) for a person receiving payments above a specified amount from a member of the SRO.

category. Accordingly, an individual who was, but is no longer, an executive officer of a listed company, can be independent under the NYSE's policies.[3]

There is also a practical reason why the NYSE has taken this position regarding indirect or former relationships with listed companies. The NYSE is fortunate to list many of the largest companies in the United States, and many of the largest companies from around the world. Experienced business men and woman who have retired from service as senior executives for such companies constitute an important pool of potential NYSE directors, knowledgeable about the public securities business, but no longer directly involved in running listed companies and so free of the potential conflict that might involve. Almost inevitably, given the large size of many of these companies, a number of potential NYSE director candidates can also be expected to have family members who are, or recently were, listed company executives. The cost to the NYSE of excluding all such candidates from consideration for its board we judged not worth the benefit. We request that the Commission reconsider the impact that this proposal would have on the NYSE.

Suggested Additions to Independence Standards

There are two elements of the independence standards adopted by the Exchange for its own board that the NYSE like to note for Commission consideration. One involves compensation received from members in the aggregate, and the other involves service with a non-member broker-dealer.

In addition to precluding independence for a person who received within the last three years more than $100,000 in direct compensation from any one member organization, the NYSE similarly precludes independence for a person who in any of the last three years received from member organizations in the aggregate direct compensation which was more than 10% of the person's annual gross income for that year. Given the need for SRO directors to oversee the SRO's regulatory activities regarding members, a material economic relationship with members in the aggregate seemed to the NYSE to be an appropriate focus of concern.

Another issue we considered relevant is a director's relationship with broker-dealers that are not members of the NYSE. Broker-dealers that do business with public customers, but are not members of the NYSE themselves, do their NYSE business through broker-dealers that are members of the NYSE. The NYSE does not directly regulate these non-member firms, but they are nonetheless an important source of NYSE business. Accordingly, the NYSE in its own director independence standards has precluded independence for anyone who is currently employed by or affiliated with such a non-member broker dealer. Insofar as the NYSE does not regulate such entities, however, we cover present relationships only, without a look-back, and do not cover relationships on the part of family members of the director. The Commission may wish to consider these issues in formulating its governance requirements for SROs generally.

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[3] The proposed rules would proscribe independent in all cases where the director, or an immediate family member, is or within the last three years was, an executive of a listed company.

Formulation of Bright Line Standards.

In formulating certain independence standards, the Commission has taken language from the existing listed company rules of the SROs, particularly the NYSE and Nasdaq. However, the proposals tend to mix and match in terms of the language used, articulating some standards using part of a NYSE rule, and part of a Nasdaq rule.

For example, proposed rule 6a-5(b)(12)(iii) precludes independence if the director or immediate family member received in any 12 month period within the past three years more than $60,000 in "payments" from the SRO or any member (including, in each case, affiliates). Both the amount and the description in the Commission proposal are taken from Nasdaq rule 4200(a)(15)(B), whereas the NYSE counterpart, in contrast, covers receipt of more than $100,000 in "direct compensation". The wording for the exception for what is earned as a director or committee member is also from the Nasdaq rule, but the wording on the exception for pension benefits is from the NYSE rule.

The following subsection (iv) of the same proposed rule deals with the test regarding director service as an executive of a company that does material business with the SRO. This provision again uses basically the Nasdaq formulation, but while Nasdaq covers payments that exceed 5% of the recipient's gross revenues or $200,000, whichever is more, and NYSE uses 2% of gross revenues or $1,000,000, whichever is more, the Commission has taken each organization's lower figure, and imposes a test of 2% of gross revenues or $200,000, whichever is more. The difference between the Nasdaq and NYSE approaches was influenced by the size of the companies comprising the bulk of their respective lists. It is not clear on what basis the Commission has settled on the numbers it proposes.[4]

Another subsection, (vii), of this proposed rule precludes independence for a director who is, or within the last three years has been, associated with the SRO's outside auditor. This subsection uses the Nasdaq formulation almost verbatim, and as a result includes an ambiguity as to whether it covers a present employee (as opposed to partner) of the audit firm. We understand that Nasdaq interprets its rule to cover present employees or the audit firm, but suggest that the proposed rules should not propagate the ambiguity.

The Commission proposal has gone beyond the similar rules of the SROs in several respects – the most important of which we discussed above regarding listed companies and audit committees. A less significant example of the same issue is presented by the bright line standard that precludes employees of the SRO from serving as independent

[4] There is another difference in the approaches taken by NYSE and Nasdaq in this context. Nasdaq applies its 5% of gross revenues test to the recipient of the payments. NYSE applies that test to the gross revenues of the other company – the company of which the director is an executive - on the theory that it is the relevance of the payment to the other company that is important. The Commission has mimicked the Nasdaq approach, applying the percentage test to the recipient. So the NYSE would have to apply this rule one way to its listed companies, and another way to itself. This is not impossible, of course, but potentially confusing, and somewhat difficult to justify.

directors. While both NYSE and Nasdaq rules, like the Commission proposal, also apply that restriction to a person whose immediate family member is an employee of the company, in the case of NYSE and Nasdaq it is a family member employed as an executive officer. The Commission's proposal would apply regardless of the status of the immediate family member – even if they were in a lower level clerical or administrative job. This is unlikely to be an actual issue for an SRO, but it is another example of a multiplicity of slightly different approaches.

We suggest that the Commission avoid picking and choosing in this manner among the standards. The Commission has approved the standards applied by each SRO to its listed company population, and any changes to those standards would also have to be approved. Why not simply require that each SRO apply its listed company standards to its own board, as the NYSE has done for approximately the last year? [5] Additional standards can be added – as the NYSE has relative to relationships with its members and its listed companies – but this suggested alternative would permit consistency in approach and interpretation at each SRO, without the Commission having to make choices from among similar, but slightly different, sets of standards.

C. **Code of Conduct and Ethics**[6]

The Release proposes to require that the rules of the NYSE provide for a code of conduct and ethics for directors, officers and employees, and further provide that the board, or the appropriate board committee, must approve any waiver of the code. The proposed rules would also require that the Exchange prohibit any of its employees or officers from being a member of the board of directors of a listed issuer or member firm. The code of conduct and ethics should, at a minimum, establish policies and procedures regarding: conflicts of interest; corporate opportunities; confidentiality; fair dealing; protection and proper use of the exchange's assets; compliance with laws, rules and regulations by directors, officers and employees; and the reporting of illegal or unethical behavior.

The NYSE Board of Directors has promulgated two codes of conduct and ethics – one pertaining to the Board itself and one pertaining to officers and employees. Both codes cover all of the topics listed above. The code pertaining to the Board of Directors is available to the public on nyse.com. The code pertaining to employees is available to NYSE employees on the Exchange's internal website, nyseandyou.com, but it is anticipated that this code will be available on the public website in the future. With respect to waivers, the NYSE would propose that it be subject to the same requirements as its listed companies, namely, that waivers for directors and executive officers would be approved by the Board and made public. With respect to waivers for other employees, Board approval is not necessary.[7]

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[5] In the event there is an SRO without its own listed company standards, it could be required to utilize the SEC-approved standards of one of the other SROs.

[6] Questions 59 and 81.

[7] *See* proposed Rule 6a-(5)(p)(1)(ii).

II.

SRO Disclosure and Periodic Reporting

A. Audited Financial Statements and Other Financial Information[8]

Revenues and Expenses

Question 92. *Are the categories of financial disclosures contained in proposed Exhibit I (regulatory program financial and other information) appropriate? Are there any categories that need to be clarified, added or deleted?*

Question 93. *Are the items in proposed Exhibit I pertaining to percentage of total budget and percentage of total revenues devoted to regulatory activities appropriate? Are there other items that should be included?*

The level of information specified in Exhibit I is too detailed and exceeds, in many areas, what public companies are required to disclose in certified financial statements. The NYSE supports transparency in its business and regulatory functions – discussed separately in the Appendix B – and believes that the Exchange should be held to the same level of disclosure as is generally required of public companies. However, we do not believe the disclosure should be more burdensome than that required by public companies. The NYSE prepares audited financial statements in accordance with U.S. generally accepted accounting principles. These financial statements and the related footnotes are prepared and audited by a registered public accounting firm. The categories of revenues and expenses in the NYSE annual report generally comport to the categories specified in Exhibit I. The granular level of description required within each category, however, is unduly burdensome. For example, the NYSE discloses market information fees; Exhibit I specifies disclosure of "market information fees, including market data fees, **itemized by product**" (emphasis added). The requirement of revenues by product would place the NYSE at a competitive disadvantage and is not required or reasonably necessary for the public. Disclosure requirements should not be so detailed as to have the effect of placing the NYSE at a competitive disadvantage with respect to and competitors in related businesses that are not SROs, and therefore not bound by the same requirements.

Exhibit I, Form 1 – Regulatory Budget

Question 94. *Are the categories of revenue and expenditures and allocated costs in proposed Exhibit I that must be disclosed with respect to the regulatory program appropriate? Are there specific categories that should be added, deleted, or clarified? Do the specified items capture sufficiently the categories of revenue and expenses that exchanges and associations currently utilize? Would it be easy or difficult for SROs to provide the requested information?*

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[8] Questions 92-98.

The NYSE maintains detailed budget and expenditure information that is segmented by enforcement, market surveillance, member firm regulation divisions and other regulatory divisions. It would not be burdensome to produce overall regulatory budgets. With respect to regulatory technology expenditures (Exhibit I, 1.c.ii.E), many systems are shared across the regulatory divisions as well as market operations, and cannot be as neatly segmented by division or itemized into the categories listed. These include data center costs, systems hardware, software, systems consultant fees and electronic surveillance systems, for example. Descriptions of this type are unlikely to fit every exchange or association and should be revised to require more general descriptions and fewer subcategories, while fairly representing the extent of the budget committed to regulatory activities, both directly and on an allocated basis.

The level of detail specified in Exhibit I with respect to the regulatory budget, however, is overly detailed. For example, section 1.c.iii. contemplates the inclusion of allocated expenses as part of the regulatory budget, but then goes further to specify that personnel expenses could be "based on a stated percentage of employee hours devoted to regulation-based activities." This is unduly restrictive and burdensome in specifying the methodology of calculating allocated expenses. A better approach would be to list appropriate general categories, such as compensation or personnel expenses, and rely on generally accepted accounting principles, public company disclosure formats and independent auditor certification, coupled with Commission oversight of more specific detail as required. It should not be necessary to the public interest in the extent of resources committed to regulation to require burdensome details.

Management Discussion and Analysis

Question 95. *Should disclosure of a discussion of unusual events or significant economic changes that have had a material effect on the SRO's financial condition be required?*

Question 96. *Should disclosure of significant business developments involving the SRO be required?*

As part of its published, audited financial statements, the NYSE addresses such issues in its Management Discussion and Analysis ("MD&A") and related Footnotes to Financial Results. The NYSE appreciates that the disclosure of significant events having a material impact on business is of interest and appropriate to the public and further believes that its current disclosures meet these requirements.

Material Commitments for Expenditures

Question 98*.* *Should disclosure of material commitments for expenditures as of the end of the latest fiscal period and the purpose of those commitments and their anticipated sources of funds be required?*

We believe that item 7 of Exhibit I is duplicative of current public financial disclosure with respect to material commitments and expenditures. With respect to requiring disclosure of anticipated sources of finds, the disclosure is unnecessary and unduly burdensome. An exchange or association may introduce a major new trading facility, for example, but to require a description of the source of funding should not be necessary.

Charitable Contributions

Question 99. *Should disclosure of charitable contributions in excess of $1,000, whether made directly or indirectly, under specified circumstances be required? Should the disclosure threshold be $1,000 or a higher or lower amount? Should all charitable contributions be disclosed? Are there other kinds of contributions that should be disclosed?*

The Commission has proposed rules that would require annual disclosure on Form 1, Exhibit I of all contributions made by the Exchange (directly or indirectly) in excess of $1,000 to a charity in which an executive officer or director (or any immediate family) is an executive officer or director of that charity. The Release states that such disclosure would enable market participants, users of the exchange's facilities, the public and the Commission to be apprised of larger charitable donations where there is a nexus between officers and directors of the exchange or association, and officers and directors of the charitable organization. The Commission also requests comment on the costs of compiling this information and whether such information is already compiled.

The NYSE already compiles with this standard and makes public most of the information requested. A list of all charitable contributions made directly by the NYSE is available on nyse.com. (http://www.nyse.com/pdfs/contributions2003.pdf). The NYSE also matches the gift of any officer or employee to the United Way, regardless of affiliation or the affiliation of family members. Grants made by the NYSE Foundation, Inc., a 501(c)(3) private foundation, are disclosed in its audited Annual Report, available on its web site. (http://www.nysefoundation.org/foundation2003.pdf). Additionally, the NYSE Foundation matches employee contributions to eligible organizations dollar for dollar up to $5,000 per employee annually. NYSE employees and directors are required to disclose any outside employment or board service on an annual basis. While that information is not currently crosschecked against charities to which the NYSE contributes, implementation of an identification process for executive officers and directors should not be burdensome. NYSE Foundation directors and officers annually disclose their affiliations with outside charitable organizations, and those relationships are identified in the listing of grantee organizations in the Foundation’s Annual Report.

With respect to the $1,000 threshold, since the Commission states its goal is to compel disclosure of "larger" donations, the Exchange believes that the disclosure threshold is too low. To put that number in perspective, the average size of an NYSE contribution in 2004 was approximately $15,000, and for the Foundation, $30,000. Since the NYSE matching level is $5,000, which occurs automatically and is not therefore indicative of

influence on the part of the director, officer or employee, the threshold should be higher than $5,000.

B. Scope and Timing of Periodic Reporting Obligations of Exchanges[9]

Question 127. *Are the time frames for providing quarterly reports, i.e., within 20 business days after the calendar quarter end, and annual reports, i.e., within 60 days after the year end, appropriate? Should they be shorter, e.g., 10 business days after the end of the calendar quarter end for the quarterly report, or longer, e.g., 75 or 90 days after the year's end for the annual report?*

The time period for filing the annual report should be longer. We suggest that 75 days would be necessary to complete the extensive reporting envisioned in the annual report. This longer reporting schedule is more in line with the Commission's current reporting requirements for public companies. (If the reporting schedules for public companies are shortened, it would not be unreasonable to conform the requirements for SROs.) Supplemental information could be provided on an extended basis. (*See* Appendix B for discussion of quarterly reporting of regulatory statistics).

C. Audit Report of Electronic SRO Trading Facilities

Question 130. *Are there issues presented by requiring the report of an annual independent audit to assess the operations of an exchange's or a association's electronic SRO trading facility for compliance with all applicable SRO rules and with the federal securities laws and regulations? Are there other ways for the Commission to achieve the same result, i.e., to determine that the operation of any electronic SRO trading facility is conducted in accordance with all applicable statutory provisions and rules? Does the proposal provide sufficient time for the independent audit report to be prepared and incorporated into the annual report? If not, what time period would be sufficient? Should the audits be required more or less often? Should the Commission establish specific criteria to determine the entities qualified to conduct such an audit and prepare a report? Should the audit be required to be conducted by an independent auditor? Would independent public auditor be capable of conducting such audits? How much would such an audit cost?*

We understand that, by the requirements of proposed Rule 17a-26(a)(2), the Commission is interested in confirming that the capabilities of electronic SRO trading facilities are in accordance with the rules relating to such systems that have been filed with and approved by the Commission. We further understand that the audit requirement applies to wholly electronic trading facilities, defined in Rule 17a-26 (j)(3) as a facility that "executes orders in securities on an electronic basis" and does not apply to manual trading facilities.[10] Electronic trading facilities of the NYSE would include the Direct+® systems and the Automated Bond System® (ABS). Question 130 addresses several aspects of the

[9] Questions 127–129.

[10] Question 81.

proposed rule that raise significant practical problems and costs. The NYSE suggests that a more flexible approach would be better.

The requirement of independence of an outside review is appropriate to ensure that the process is objective. It is also appropriate that the Commission leave room in the requirement of independence for any qualified entity that is not an affiliate of the particular SRO. We note that the NYSE has employed from time to time the consulting or auditing services of several major accounting and auditing firms and exclusion of any firm that has previously provided services to the SRO would leave us a very limited universe to choose from. We agree that the third party should be qualified to render an opinion on complex trading systems and do not recommend that the Commission establish criteria for qualifications.

With respect to the scope of the audit, we expect that the audit will encompass the essential aspects of system functionality of the electronic trading systems as described in the enabling rules in accordance with generally accepted auditing standards. It is understood that if an audit is beneficial, the SROs should bear the cost, but it should be noted that as a practical matter, the Rules Proposal understates the projected cost of such an audit. For a complex trading system, it is more probable that 100 hours of audit time would be necessary just to prepare an estimate of the scope of the audit. Even with the availability of outsourcing audit services abroad, it is unlikely that a qualified audit could be performed for $100 an hour. In recent years, the cost of qualified consultants on technical systems has exceeded that amount even for narrowly circumscribed services. Thus, the cost of an audit is likely to be considerable. We also note that the costs of audits are imposed upon exchanges and associations that are SROs, but would not fall equally on market participants such as electronic trading networks or ECNs that are not registered with the Commission. This is a burden on competition and a further reason why the costs of such audits should be reasonably limited with respect to the scope and frequency of the audit.

Additionally, the provision of the proposed rule that specifies the audits be conducted annually is unduly burdensome on SROs without necessarily achieving the beneficial purposes of the review. The present proposal calls for an annual audit to be filed as part of, and on the same timetable as, the annual report. The initial audit may be beneficial if a new trading facility is approved or fully implemented. An annual audit would not seem to be necessary if there has not been a material change in the electronic trading program. A change to increase capacity without changing the trading rules should not be considered a material change. Therefore, we take the position that an annual audit is not necessary. Although we do not recommend an annual or frequent audit of trading systems that have not undergone material changes, we suggest that the frequency be three years rather than one year if the Commission opts for a single standard.

As an alternative to an annual audit, it would be as reasonable if in approving an SRO electronic trading facility, the Commission specified in the approval order the time period for the first audit and the frequency thereafter. For example, the NYSE has filed for consideration by the Commission a proposed rule for a new Hybrid Market trading

facility. The requirement for an audit would be reasonably expected to follow full implementation of the trading facility.

Moreover, the timing of the annual audit, coinciding with the timing of the annual report, *i.e.*, within 60 calendar days after the year end, Rule 17a-26(a)(1), compresses the entire burden of the annual report into the same timeframe as other, significant corporate and public reporting responsibilities, although the introduction of new trading systems would not necessarily occur on a calendar year schedule.

SEC SRO RULES PROPOSAL RELEASE NO. 34-50699
REGULATORY APPENDIX B

I.

Fair Administration and Governance

A. Separation of Regulatory and Market Operations

The NYSE supports the Commission's Governance proposals. The NYSE recently completed an intensive self-evaluation of its governance and transparency, much of it in the public eye and subject to intense scrutiny by market participants and the Commission. As the Rules Proposal noted, the Commission approved the NYSE's new governance procedures and structure, following the approval of changes to the underlying Constitution of the NYSE by its members.[1] These new requirements meet – and in many aspects exceed – the standards proposed by the Commission with respect to fair representation of members and governance of SROs.

As an essential part of that process, the NYSE formalized and enhanced the effective separation that generally existed between the regulatory program and the competitive business functions. Regulatory personnel no longer report to the Chief Executive Officer ("CEO"), and regulatory functions have been placed instead under the supervision of a Chief Regulatory Officer ("CRO"). The CRO, in turn, reports to the Regulatory Oversight Committee of the Board of Directors ("ROC"), which consists entirely of independent directors. The new ROC, together with the CRO, are vested with full authority to set budget and staffing levels, including the technology budget that supports the regulatory program. Thus, apart from certain common administrative areas (described more fully below), regulation operates free of the ostensible conflicts that may arise from other institutional aspects of the NYSE's business.

We agree with the Commission that this structure – a separate regulatory executive reporting to an empowered, qualified and independent board, amply funded and professionally staffed – adequately assures the integrity of the regulatory process.
We have the following general observations concerning the regulatory impact of the proposed rules, as well as some technical comments on the proposed rules as they relate to the NYSE's regulatory processes.

Independence of the Regulatory Program[2]

Question 20*. Are the provisions relating to the separation of regulatory functions from any market operations and other commercial interest of the exchange or association appropriate? Should the proposed governance rules require the regulatory function and market operations and other commercial interests of an exchange or association to be*

[1] *See* Securities Exchange Act Release No. 48946 (December 17, 2003).

[2] Questions 1-60. Specific questions as to which the NYSE recommends changes will be set out in the text.

conducted in separate legal entities? What would be the consequences of any such requirement? Would such a requirement mitigate conflicts of interest? If so, how? Are there other requirements relating to the independence of the regulatory function that should be implemented?

The NYSE strongly endorses the continued independence of its regulatory program, a program that is both free from compromise or pressure from other segments or interests at the NYSE and free from the influence of possibly coercive outside forces. As we have indicated elsewhere, we believe that the present structure of the NYSE mandates and achieves this result.

The recently crafted architecture of the NYSE is intended to functionally, though not physically, separate the NYSE's regulatory elements from its marketplace and listed company operations by placing the regulatory elements under the supervision of a CRO reporting to a fully independent ROC. We believe that this functional separation ensures the independence of the regulatory program, and that no significant additional benefits can be achieved by requiring a legal, as opposed to functional, separation of regulation from the marketplace operations. Thus, we believe that a full-fledged legal separation of the regulatory and business functions is unnecessary and would not be useful in achieving the Commission's overarching goals.

Significantly, the NYSE's experience demonstrates that the functional separation model currently in place can successfully diminish potential conflicts of interest between business demands and regulatory obligations. Under the new structure, for example, the NYSE's historical regulatory functions – market surveillance, member firm regulation, and enforcement – have been placed under the supervision of the CRO and no longer report to the CEO or to a board consisting of persons or entities that the NYSE regulates. In addition, two other areas that previously reported ultimately to the CEO – arbitration and listed company compliance[3] – now report to the CRO under the NYSE's regulatory side in recognition of the potential for conflicts of interest between those areas and the NYSE's marketplace operations.

Regulatory fees, fines, and penalties have also been tracked to ensure that they fund solely regulatory functions and are not considered business-side revenues. At the same time, to preserve operational efficiencies (thus leaving more resources for regulatory activities), common administrative areas that are not subject to the same potential conflicts of interest – human resources, financial accounting, security, and the like – are shared Exchange-wide. The integrity of this process is safeguarded by the constitutional underpinnings of the described structure; by the independence policy of the Exchange's Board of Directors; by the authority vested in the ROC; by the NYSE Directors' Code of Business Conduct and Ethics; by the provision in the NYSE Constitution for the removal

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[3] Two departments, corporate governance and financial compliance, together are responsible for listed company compliance.

of directors for failure to discharge duties; and by the Officers' and Employees Statement of Business Conduct and Ethics.[4]

Significantly, no additional safeguards would result from segregating regulation into a separate legal entity. Indeed, the current structure enables NYSE Regulation to derive the benefits of a common infrastructure (benefits that would be foregone if it were a separate legal entity), but still operate free of ostensible conflicts which might otherwise arise from a more integrated management structure.[5] In practice, this structure is not inferior to a separate legal entity since approvals for regulatory action, decision-making, and expenditures are neither required nor sought from the non-regulatory side of the NYSE. Moreover, the responsibility of the ROC of the Board ensures that Regulation will receive the Board's attention, support and oversight that it requires. The prevailing functional separation ensures proximity to the regulated market but minimizes the likelihood of competitive influence. In this respect, the legal structure in which regulators operate matters less in our view than the integrity of, and controls on, the regulators themselves. Accordingly, the rules should not require anything more than a functional separation between the regulatory and business interests.

C. Use of Regulatory Fees, Fines and Penalties[6]

Question 26. *Is the requirement that an exchange or association apply funds received from regulatory fees, fines or penalties only to fund programs and operations directly related to such exchange's or association's regulatory responsibilities appropriate. Is the scope of which funds would be included in the requirement clear? Is it broad enough, or are there other sources of remuneration that should be included? For instance, should issuer fees be considered regulatory fees? Should the Commission define the term "regulatory fees"?*

We agree that all regulatory fees, fines and penalties should be earmarked for an exchange's or association's regulatory functions, and that exchanges and associations should put in place financial controls and reporting to that effect. We note that in an integrated structure (that is, one in which regulation is a functionally, though not legally, separate entity), exchanges and associations should be permitted to use regulatory fees, fines and penalties in part to fund that portion of shared expenses that have been fairly allocated to regulation. We do not believe that such a use is inconsistent with the proposed rules. As the Commission approves all fees of SROs, it has the authority to achieve a level playing field with respect to definitions of fees. We do not recommend

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[4] The Directors' Code of Ethics has been amended to emphasize this principle. The Ethics Statement will be supplemented to explicitly mandate that the integrity of the regulatory process is to be preserved and maintained, prior to final Commission approval of the Rules Proposal.

[5] The NYSE believes that even beyond operational synergies, there are significant regulatory benefits to be derived from having regulation and marketplace operations coexist within a single entity. The NYSE intends to more fully address those manifold benefits in response to the Commission's concept release on SRO governance

[6] Questions 26-29

defining regulatory fees beyond the identification in present rules. In our view, listing fees, transactions fees, technology fees and market data revenues would not be considered regulatory fees. The NYSE maintains the position that it has taken in previous comments on regulatory structure[7] that NYSE Regulation has multiple sources of revenue and is not dependent on regulatory fees, fines and penalties as its sole source of funding. All regulatory fees, fines and penalties are devoted to regulation under the current structure of the NYSE, but as regulation supports all business lines, revenues from any and all sources will fund regulation if such fees are insufficient in any year.

C. **Confidentiality of Regulatory and Trading Information**

***Question 30**. Is the proposed requirement that an exchange or association implement policies and procedures to maintain the confidentiality of regulatory and certain other information appropriate?*

***Question 31**. Is there any other type of information other than regulatory information and information required to be submitted to effectuate a transaction that an exchange or association should be required to keep confidential? Should such information include information gained in the course of applications for listing on the exchange?*

***Question 32**. Should an exchange or association be allowed to disseminate such information (other than regulatory information), including order and trade data, in an aggregated form, as proposed? If so, are there any restrictions, in addition to those proposed, that should be required so that the information is truly aggregated?*

***Question 33**. Is the proposed definition of "regulatory information" appropriate? Is it too broad? Or, should the prohibition on use of regulatory information for other than a regulatory purpose include information other than information gained in the course of carrying out regulatory obligations? If so, what information?*

***Question 34**. Would the proposed limitations on disseminating regulatory information and information required to be submitted to effectuate a transaction restrict an exchange or association from being able to disseminate information that currently is disseminated by exchanges or associations? If so, how so?*

***Question 35**. Should an exchange or association be allowed to disseminate order and trade data, or regulatory information, which is otherwise made public by a person other than the exchange, association, or an officer, director, employee, or agent of the exchange or association?*

We strongly believe that the confidentiality of regulatory information must be preserved and never used for competitive advantage. As a general proposition, we are concerned

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[7] *See* NYSE Comment Letter of June 19, 2003 to Securities Exchange Act Release No. 34-47849/File No. S7-11-03, *Request for Comment on Nasdaq Petition Relating to the Regulation of Nasdaq-Listed Securities*.

that the focus of the proposed rules is on preventing the dissemination of regulatory information rather than safeguarding the appropriate use of such information. We are also concerned that the definition of regulatory information is overly broad. We note that longstanding NYSE policies are consistent with the Commission's proposal. In particular, the NYSE has long had a Code of Ethics for employees and officers, with specific provisions for safeguarding confidential information and the monitoring of employees' securities transactions.

The present language of the rule,[8] however, could inadvertently require the NYSE to completely sever communication between regulation and the other areas of the NYSE. For the reasons discussed below, we do not believe this result is consistent with the public interest. We also believe there is no public benefit to diminishing the transparency of NYSE operations in the name of informational security or limiting access to NYSE investor-related and scholarly constituencies, and that the Commission did not intend either of these results.

Proposed Rule 6a-5(b)(17) defines "regulatory information" as "any information collected by a national securities exchange in the course of performing its regulatory obligations under the Act." In defining regulatory information so broadly, such restrictions may have the unintended consequence of preventing the sharing of information that is either essential to the NYSE's regulatory functions or consistent with the goals of self-regulation.

The Commission's discussion of the proposed rule suggests in footnote 208 that special protections were intended to encompass "information relating to an on-going disciplinary investigation or action against a member, the amount of a fine imposed on a member, financial information, or information regarding proprietary trading systems gained in the course of examining a member." We agree with that application of the Rule, but we note that this list of examples is far more limited than the definition in Rule 6a-5(b)(17) would suggest. Thus, at the very least, we would request that the Commission clarify the

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[8] Proposed Rule 6a-5(n)(5) provides:

> (i) A national securities exchange must establish policies and procedures reasonably designed to:
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> (A) Prevent the dissemination of regulatory information to any person other than an officer, director, employee, or agent of the exchange directly involved in carrying out the exchange's regulatory obligations under the Act;
>
> (B) Prevent the use of regulatory information for any purpose other than carrying out the exchange's regulatory obligations under the Act; and
>
> (C) Maintain the confidentiality of any information required to be submitted to effectuate a transaction on or through such exchange or its facilities, unless such information is aggregated to such an extent that no person whose information is included in the aggregated information can be identified, or unless the person has consented to the dissemination and use of its information by the exchange.
>
> (ii) An exchange's policies and procedures must require its officers, directors, employees, and agents to agree to comply with the requirements of paragraph (n)(5)(i) of this section.

intended scope of proposed Rule 6a-5(b)(17) by incorporating the language of footnote 208 into the definition.

More generally, however, we believe that focusing on a definition of "regulatory information" alone will not clearly prevent the type of conduct – in particular, unfair competitive uses of regulatory information – that the proposed rule seeks to address. Instead, we believe that the Commission should focus on identifying appropriate uses of "regulatory information" and the procedures and controls that an SRO should have in order to effectively manage and monitor the uses of such information, rather than prevent the use of "regulatory information." The rules should strive for more stringent controls for information of a disciplinary nature, for example, than for trading information collected for both regulatory and business purposes.

In important areas, the regulatory function requires communication with non-regulatory personnel; this may involve the sharing of information collected partly for regulatory purposes, but that regulatory staff share and consult with non-regulatory staff in order to fulfill regulatory responsibilities. For example:

- Floor operations or other business units are often helpfully consulted for assistance in obtaining information in connection with investigations of potential misconduct. Market Surveillance staff, in the performance of its assigned functions, needs to establish a presence on the Floor of the Exchange and interact with Floor Operations staff and members not involved with transactions operating as Floor Officials.

- Corporate governance and financial compliance departments, in fulfillment of listed company compliance functions, must receive from and share information with business units within the global corporate client group and listings representatives staff in order to effectively assess original listings standards and monitor listed companies' compliance with corporate governance and continued listing standards.

- Member firm regulation staff may make available a number of non-source identifiable aggregations of financial information about members and member organizations both within and without the Exchange.

- Complaints may be received from the business side and transmitted to the regulatory side. It is appropriate for the listed company representative or business staff to follow-up, without influencing the regulatory deliberative process.

- Background checks may be requested by business staff of regulatory staff (similar requests are made to Commission staff) with respect to prospective listing applicants, prospective member organizations and associated persons, in connection with the allocations of securities to specialist firms, nominations for Floor Officials and committee assignments and other areas involving positions of public trust or integrity.

- The regulatory quality review and internal audit functions of the NYSE are outside and independent of the regulatory divisions. In order to accomplish their functions, they are granted full access to regulatory systems, databases and files in the conduct of their reviews. Under proposed Rule 6a-5(n)(5) as presently drafted, this use would be inconsistent. The NYSE would recommend that this function be specifically exempted from the limitations on the use of regulatory information.

- Various types of market information regularly collected or filed by firms pursuant to standing rule requirements or filing protocols have multiple regulatory and business uses. This type of information includes filed reports collected under regulatory authority but shared for well-known and understood programs, for example, program trading activity on Daily Program Trading Reports, short interest reporting, reports of specialist capital, transactions, positions, performance and measurements of specialist activity. Additional examples include the full audit trail of transactions, quotes, cancellations, executions, comparison, questioned trade processes and consolidated tape reporting – any and all of which may be used for regulatory and business purposes.

Significantly, for purposes of assessing the impact of proposed Rule 6a-5(n)(5), these categories must be clearly distinguished from information requested in the course of reviewing complaints, conducting investigations or prosecuting disciplinary hearings, which are confidential and not shared with the non-regulatory departments until proceedings are concluded or information must be made public for the protection of investors or to avoid disruption to the public trading of securities. Investigatory and disciplinary information clearly is, and should be, protected from disclosure since it may involve proprietary information or reveal the direction of pending matters. The argument in favor of shielding the other categories from disclosure, on the other hand, is less compelling since the data originates from outside the regulatory area and has multiple uses. Indeed, the fact that the information is received by some segment of the regulatory group (either as the primary recipient or as one of many recipients) does not change the essentially non-regulatory nature of the data at issue. Moreover, the fact that a regulatory group may organize and analyze this data also does not change the nature of the underlying data.

For instance, member firms are required to report program trading data to the NYSE's market surveillance division, which analyzes enumerated strategies for manipulative patterns or other trading violations. Because market surveillance as an administrative function "collects" such information, it technically constitutes "regulatory information" that under a strict reading of the proposed rules as presently drafted would restrict dissemination. Such an approach ignores the fact that this data is essential to the functioning of the NYSE as a market, and that far from being disadvantaged, investors *benefit* from its dissemination. Among other uses, the Exchange's research department and others use this data for statistical analysis and study; the trading technology department uses this data to track program trading levels for capacity analysis; the competitive position department uses this information to better understand customers'

needs. In addition, generic categories of program trading levels are published to the investing public, and contribute to informed decisions by investors.

Another example involves data that specialist firms are required to report to the NYSE that is in turn used by various areas of the NYSE for regulatory as well as non-regulatory purposes. The NYSE, moreover, consolidates some information through its trading systems and makes that information available to the firms who participate in the transactions following comparison to assist the firms in managing the information necessary to maintain a fair and orderly market in assigned stocks and to maintain adequate capital in compliance with federal and exchange rules. Aggregate levels of specialist activity are published in the NYSE Fact Book. Specific levels of specialist activity by stock and time period may be used in regulatory evaluations of the maintenance of a fair and orderly market. Allowing the fact that this information is collected by regulation to neutralize the beneficial uses of this information outside of regulation would undermine rather than strengthen the Commission's stated goals in this regard.

Yet another example of information collected for multiple uses is specialist turnaround time on DOT orders, responses to administrative messages, and timeliness of openings and closing transactions. These objective performance measures and data are used in analyses generated by market surveillance analysis for regulatory purposes but is also used in the Allocation Process and are, at different times and in different forms, provided to the specialist firms as performance feedback in order to help the firms improve the quality of markets in their specialty stocks. Both of these latter functions are core business functions for the specialist firms, yet both also benefit listed companies and the investing public. If the NYSE were precluded from disseminating such data because of its regulatory applications, the investing public would actually be disadvantaged.

The Commission has previously approved certain disclosures of "regulatory information". For example, rules approved by the Commission with respect to the NYSE's Allocation Policy require that the disciplinary history of firms and individual specialists be considered in assigning new listing and stocks to particular specialist firms.[9] Under these rules, the Allocation Committee is provided confidential information about approved and pending non-public disciplinary actions (but not investigations) as well as non-public completed informal disciplinary actions such as admonition letters and summary fines for the important purpose of evaluating qualifications for stock allocations. These approved uses of "regulatory information" should be incorporated in the proposed rules.

Another important and approved process for the sharing of regulatory information involves the entire corporate governance and financial compliance areas constituting listed company compliance functions.

Insofar as the proposed Rule 17a-26(b)(3)(iii) requests "a complete discussion of internal controls implemented … to detect, prevent and control for any conflicts ... between the …

[9] *See* Exchange Rule 103B.

commercial interests of the exchange … and its self-regulatory responsibilities," as previously noted, the NYSE not believe that it is either wise or appropriate to interdict all communications between and among the various departments and areas of the Exchange. A recent Commission Report indicates that failure to communicate regulatory concerns could undermine the public interest.[10] As noted by the Commission and Congress, regulation works best the closer it adheres to the subject matter being regulated. The appropriate yardstick, within the context of this exchange's governance structure, is that the confidentiality of source identifiable regulatory information as to which confidentiality is reasonably expected by the provider without compromising the surveillance, enforcement and examination work-product of the Exchange regulatory staff.

The NYSE is committed to assuring the integrity of the regulatory process. But as the examples described above make clear, assuring the integrity of the regulatory process does not require a virtual information blackout between and among the various areas of the NYSE as proposed. Such a strict barrier would, we believe, run counter to the goals of self-regulation and the Commission's stated goal of promoting transparency. The NYSE agrees that confidential treatment should be accorded to source-identifiable regulatory information (including enforcement, surveillance and examination specifics) reasonably expected by its providers or subjects to be treated confidentially, recognizing that there are situations in which regulatory obligations require the disclosure of "regulatory information" to the business side or outside the NYSE. While such disclosures should be limited, controlled, and carefully monitored in order to ensure that regulatory information is not used for non-regulatory commercial purposes, such disclosures do not, in any way, undermine the Commission's intent to free regulation from undue influence or expectations of the business units of the NYSE. For these reasons, an absolute bar on information disclosure is not required.

D. **Code of Conduct and Ethics**[11]

As a general matter, we agree with the Commission that SROs should have policies and procedures in place with respect to: conflicts of interest; corporate opportunities; confidentiality; fair dealing; protection and use of exchange assets; reporting of illegal or unethical behavior and the rules of the exchange and applicable laws, including protecting confidentiality of regulatory and proprietary information. The NYSE believes that the list of categories in proposed Rule 6a-5(p)(1)(i) is sufficiently comprehensive and that additional categories are unnecessary. In this regard, we note that the NYSE's existing Statement of Business Conduct states unequivocally that "it is Exchange policy to treat all sensitive non-public information from and relating to listed companies, members and member organizations" as confidential and prohibits the disclosure of such information "except in the performance of… assigned duties, or where the release of such

[10] *See* Securities Exchange Act of 1934 Release No. 51163/February 9, 2005, *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding the Nasdaq Stock Market, Ind., as Overseen By Its Parent, The National Association of Securities Dealers, Inc*., which underscores the need for regulatory information flow.

[11] Question 59.

information is authorized by the appropriate officer of the Exchange, or is required by law."

We believe that the NYSE's existing Statement of Business Conduct addresses the items set out in proposed Rule 6a-(5)(p). It is appropriate that SROs have the flexibility to draft policies in a manner that is consistent with that SRO's unique governance structure. We do not agree, however, that the Board must approve any waiver of the employees' code of conduct and ethics. A distinction should be drawn between directors and executive officers, on the one hand – as to whom board approval of waivers is appropriate – and non-executive officers and employees as to whom the requirement of board approval is not necessary. *See* Proposed Rule 6a-(5)(p)(1)(ii).

E. **CEO vs. CRO Disclosure Certification**

Question 146*. Is the certification requirement appropriate? Is the chief executive officer the appropriate official to certify the quarterly and annual reports on behalf of the exchange or association? In light of the provision of proposed Rules 6a-5 and 15Aa-3, which would require exchanges and associations to establish a Chief Regulatory Officer, would it be more appropriate for the Chief Regulatory Officer to certify the required reports, or for both officers to certify?*

The NYSE agrees with the Commission that good corporate governance practices should include a requirement that a senior officer of the NYSE certify the various public disclosures called for in the proposed rules. We note that the proposed rules indicate that the certification should come from the CEO, but question whether the CEO is the proper officer to perform that function, particularly where the CEO would be certifying as to information provided by and in the control of the regulatory group. Given the Commission's views on regulatory independence, and assuming that the Commission agrees that functional separation of regulation and market operations is an acceptable model, such a certification should be more appropriately made by the CRO rather than the CEO, except for such information that originates at the business side, *e.g.,* financial information.

II.

SRO Disclosure and Periodic Reporting[12]

A. **Exhibit H – Form 1**

The NYSE believes that, as a general matter, the disclosures in proposed Exhibit H are both relevant to an understanding of the regulatory functions. The NYSE has been providing much of this information to the Commission on a regular basis. We also agree that it is useful for the investing public and market participants to have access to meaningful descriptions of the NYSE's regulatory program areas. Exhibit H to the proposed Form 1 Registration Statement would require that the NYSE "describe fully" its

[12] Questions 125-149.

regulatory program, including "the process for assessment and development of regulatory policy," "significant changes planned" and "new significant regulatory issues" that may have an effect on "the mission, strategy, and future operations of the applicant's regulatory program."

The NYSE already achieves a significant level of transparency with respect to the functioning of its regulatory program. Disclosure about the regulatory program is widely available:

- A description of each aspect of the NYSE's regulatory program is already set out at its website, as are its organizational structure, rules and rule filings;
- A member of the public seeking to understand the architecture and operation of the NYSE already has numerous factual entrées, as do scholars and researchers, via the NYSE's research reports, Fact Book, and other publications;
- The listed company and member organization community are also knowledgeable participants in Exchange operations and governance through access to the NYSE's Listed Company Manual, Rulebook, advisory committees, standing committees, and publicly available rule-filings; and
- The Commission, through its frequent inquiries and inspections, the filing of numerous reports and statistics, the proposed requirements of Rule 17a-26 quarterly and annual reports, the Rule 19b-4 process, and various other means, has in-depth knowledge of NYSE functions and processes.

B. **Quarterly Reports**

The Exchange has reviewed the eight items[13] enumerated in proposed Rule 17a-26 for inclusion in the proposed quarterly reports and the related time frames and believes that the item requirements can be met.[14] In order to reduce the reporting burden, it is

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[13] We assume that the material called for by Rule 17a-26(b)(2)(i) relates to market surveillance matters. With regard to subsection (b)(2)(ii), net capital computational errors are unlikely to be discovered until some time after the event unless self-reported by the subject organization. The requested figure for "average elapsed time" with regard to investigations, examinations, and enforcement actions would be of little utility since the time frames involved depend on the nature (*e.g.*, for-cause, cycle, financial and operational ("Fin-Op"), sales practice review unit ("SPRU"), complexity, and novelty of the issue or exam, the size of the organization, and its prior history. It also is noted that certain of the itemized requirements of the quarterly reports include both "objective" descriptions and "factual" descriptions. It is our understanding that these terms are not substantially different and that the appropriate level of detail so as to identify the principal character of the complaint may be drawn from the comment fields of the exchange's automated tracking databases.

[14] The "unique identifier" for "associated persons" will be determined in discussion with Commission staff as to the format of the reports, inasmuch as non-registered persons are not captured by CRD. With respect to member organizations and registered persons, it is anticipated that the unique identifier will be system generated so as not to require a completely new or duplicative system of nomenclature. *See* Question 135.

understood that the Commission is not requesting that the same or similar material be reported in different formats.[15] There is, however, a problem with respect to the 20-day period for filing dates inasmuch as the major quarterly (and third month) financial reports filed by member organizations are not filed until 17 business days after the close of the period.[16] Thus, NYSE staff would have insufficient time to categorize filings as late or amended and to determine whether any consequent action is appropriate.[17] We suggest that 40 days would be more reasonable for quarterly reports.

As proposed Rule 17a-26 is currently drafted, it requires a fourth quarterly report to be filed in advance of the cumulative statistics filed with the annual report. It would be less burdensome on the exchanges to combine the fourth quarter report filing time with the annual report.[18]

The Commission has indicated its hope that the descriptions of the various SRO programs be candid and affords the basis for a dialogue between the NYSE and the Commission staff. The annual report also is to enclose self-evaluations conducted by the stated standing Committees of the NYSE – evaluations prepared by independent directors of the NYSE – persons of probity and experience who have undertaken the performance of their assigned duties in good faith. To formally deem all such material as "reports" for purposes of the liability provisions of Sections 18 and 32 of the Exchange Act seems unwarranted, excessive and counter-effective.[19]

C. **Annual Reports**

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[15] For example, the Exchange presently provides the Commission with copies of exam reports, MOU reports. The listings department supplies periodic statistics on securities listed, delisted, or notified of non-compliance with a rule or standard for continued listing. See Rule 17a-26(b)(2)(iv). With respect to Question 137, in our view this level of detail is sufficient without the additional requirement of reporting on the compliance plans of the subject securities.

[16] Financial and Operational Combined Uniform Single Report ("FOCUS"). We also note that a few member organizations have specifically allotted time frames for filing.

[17] The Exchange believes that the format and underlying technology be left to the discretion of each SRO.

[18] Question 129.

[19] Although periodic reports under Rule 17a-26 would fall within the well-established exemptions of the Freedom of Information Act ("FOIA") and would be accorded confidential treatment upon standards promulgated by the Commission, as Question 147 notes, in light of the regularity of filing of the proposed reports, we would support a streamlined procedure for periodic reporting. Given an environment wherein periodic reports are about to become formalized and systemized, it should follow that an SRO need not comply with cumbersome reverse-FOIA procedures and that the Commission staff be released from the administrative burden of processing these routine requests. Since it is beyond dispute that at least FOIA exceptions 4 and 8 apply to such material, and that the Commission has the authority automatically to apply FOIA Exemption 4 and 8 to these and like material, and has done so in other instances, it can and should so streamline this process.

We concur with the discussion of due dates in the Business Section that the time period for filing the annual report should be longer. We suggest that 75 days would be necessary to complete the extensive reporting envisioned in the annual report.

D. Reporting of Interim Changes Affecting the Regulatory Program[20]

We understand that this requirement is intended to require disclose of material changes to the regulatory program made or projected since the annual report. An example of a material change would be if the reporting format of the quarterly reports should change in a material way, such as the retirement of a surveillance or the introduction of a new surveillance, program or examination scope.

E. Conclusion

The Commission has highlighted in the rules proposal the most significant issues and concerns regarding the independence and oversight of self-regulatory organizations (SROs). We agree that the self-regulatory functions should not be not unduly influenced by the business interests of the exchange or association. Indeed, the Exchange staff works hard and with great diligence to make self-regulation work, and takes great pride in the integrity of its regulatory program.

We recognize that the competitive nature of the securities industry creates the potential for conflict of interest within exchanges and associations. As such, we support proposals to enhance disclosures and periodic reporting on regulatory activities that in turn facilitate Commission oversight and public understanding of SROs.

[20] Question 148.