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February 7, 2006

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
Station Place
100 F Street, NE
Washington, DC 20549-9303

Re: Response to Comments to File Number SR-NYSE-2005-77 – Relating to the Proposed Merger between the New York Stock Exchange and Archipelago

Dear Ms. Morris:

The New York Stock Exchange, Inc. (the "*NYSE*") hereby submits its response to public comment letters received by the Securities and Exchange Commission relating to the NYSE's Proposed Rule Change (File Number SR-NYSE-2005-77).

The SEC received 13 letters in connection with the Proposed Rule Change,[1] seven of which provided comments on and suggested amendments to the Proposed Rule Change.[2]

[1] *See* (1) letter from the Independent Broker Action Committee, Inc., dated December 16, 2005; (2) letter from Andrew Rothlein, Michael Wallach, Gregory Tenbekjian, Ken Marks, Pamela Rothlein, Enid Wallach and Mary Ann May, dated December 23, 2005; (3) letter from James L. Kopeky of James L. Kopeky, P.C., January 16, 2006; (4) letter from the Bond Market Association, dated January 23, 2006; (5) letter from the Securities Industry Association, dated January 18, 2006; (6) letter from the Nasdaq Stock Market, Inc. ("*Nasdaq*"), dated January 25, 2005; (7) letter from National Association of State Treasurers, dated January 31, 2006; (8) letter from the Investment Company Institute, dated February 2, 2006; (9) letter from the Securities Industry Association and the Bond Market Association, dated February 2, 2006; (10) letter from California Public Employees' Retirement System ("*CalPERS*"), dated February 2, 2006; (11) letter from Michael Kanovitz of Lowey & Lowey on behalf of Lewis J. Borsellino, dated February 2, 2006; (12) letter from the Independent Broker Action Committee, Inc., dated February 2, 2006; and (13) letter from Nasdaq, dated February 2, 2006.

[2] *See* (1) letter from the Independent Broker Action Committee, Inc., dated December 16, 2005; (2) letter from Andrew Rothlein, Michael Wallach, Gregory Tenbekjian, Ken Marks, Pamela Rothlein, Enid Wallach

Set forth below is the response of the NYSE to those comments that are within the scope of the Proposed Rule Change.

BACKGROUND

The NYSE submitted the Proposed Rule Change to the SEC in connection with the NYSE's proposed merger with Archipelago Holdings, Inc. Following the merger, the businesses of the NYSE and Archipelago will be held under a single, publicly traded holding company named NYSE Group, Inc., a Delaware corporation, and the NYSE's current businesses and assets will be held in three separate entities affiliated with NYSE Group: (1) New York Stock Exchange LLC, a New York limited liability company, (2) NYSE Market, Inc., a Delaware corporation, and (3) NYSE Regulation, Inc., a New York Type A not-for-profit corporation. The merger will have the effect of:

- converting the NYSE from a not-for-profit entity into a for-profit entity (other than with respect to the regulatory responsibilities currently conducted by the NYSE, which will be separated into a not-for-profit entity);

- demutualizing the NYSE by separating equity ownership in the NYSE from trading privileges on the NYSE; and

- combining the businesses of the NYSE and Archipelago under NYSE Group, a publicly traded holding company.

With the exception of NYSE Regulation, NYSE Group and its subsidiaries will be for-profit entities, rather than not-for-profit entities. The conversion from a not-for-profit entity to a for-profit entity will increase the NYSE's capability to invest in its growth both internally and through acquisitions, and increase its focus on efficiency and cost reduction. Further, as a public, listed company, NYSE Group will have improved access to capital, and the ability to engage in future transactions using its stock as acquisition currency. The NYSE also expects that, after the merger, NYSE Group will have much greater flexibility and ability to respond more quickly to global competitive pressures than the NYSE's current membership structure permits. In addition, as a for-profit entity, NYSE Group will have increased transparency and a better ability to invest in new technology, offering greater choice for investors.

The Proposed Rule Change seeks to preserve and extend after the merger the functional separation, yet pervasive communication, between its business and regulatory activities achieved under the NYSE's current governance architecture, which was comprehensively

and Mary Ann May, dated December 23, 2005; (3) letter from Investment Company Institute, dated February 2, 2006; (4) letter from CalPERS, dated February 2, 2006; (5) letter from the Securities Industry Association and the Bond Market Association, dated February 2, 2006; (6) letter from the Independent Broker Action Committee, dated February 2, 2006; and (7) letter from Nasdaq, dated February 2, 2006.

reformed in 2003. It also seeks to insulate the NYSE's self-regulatory function from the additional cross-currents created by demutualization and public ownership.

RESPONSE TO COMMENTS

1. A complete spin-off of NYSE Regulation is not necessary and would reduce the benefits of self-regulation

The Independent Broker Action Committee, CalPERS and Nasdaq each contend that there should be a complete separation of NYSE Regulation from NYSE Group. CalPERS also suggests that the NYSE Regulation board should be comprised of individuals appointed directly by the SEC.[3] The NYSE disagrees with these suggestions.

Close ties between regulation and the market improve self-regulatory performance by ensuring knowledgeable regulators and more expertly regulated markets

As the SEC has noted, the system of regulation of the nation's securities markets is based on the principle of self-regulation, which has largely been judged a success and as having served government, industry and investors well.[4] One of the advantages of self-regulation is that it allows the securities industry to be "supervised by an organization familiar with the nuances of securities industry operations."[5]

Self-regulation is based on the premise that a close tie between the regulators and the marketplace provides the best protection for investors and markets. The rationale is straightforward: Regulators are in the best position to regulate when they are intimately knowledgeable about the activities they are regulating. Market regulators who are integrally tied to the regulated market know the conduct and activities that they should be examining when they engage in compliance reviews and surveillance. This knowledge

[3] CalPERs bases its suggestion for separation on the erroneous premise that the "current model for regulation of and by the . . . Exchange has failed", citing events rooted in misconduct that predated the NYSE's 2003 restructuring of its governance and its functional separation of NYSE Regulation. *See* letter from CalPERS, dated February 2, 2006.

[4] *See* Exchange Act Release No. 50700 (December 8, 2004).

[5] *Id*. Recently, the SEC has solicited comment on proposed reforms known as Regulation SRO, which relates to strengthening the system of self-regulation in light of industry developments such as demutualization, increased competition and other changes. *See* Exchange Act Release No. 34-50699 (December 8, 2004). Regulation SRO is based on the principle that, by implementing certain corporate structure and governance mechanisms, a national securities exchanges is able to preserve the benefits of self-regulation, while insulating their regulatory operations from undue pressure from its business interests and its member organizations. The commentators who have urged a complete spin-off of NYSE Regulation are essentially criticizing this underlying principle of Regulation SRO. The NYSE respectfully submits that the proper forum to voice these concerns is in the comment process for Regulation SRO and the accompanying "concept release," not the NYSE's Proposed Rule Change, which the NYSE designed to comply with the proposed rules of Regulation SRO.

also allows regulators to know when rule changes are needed to address systemic concerns. A regulator with a real-time understanding of how the marketplace is evolving in the face of competitive forces will not be forced to play catch-up, but instead has a better chance of keeping ahead of the curve and being integrally involved in shaping marketplace evolution to ameliorate any regulatory concerns. A regulator who is proximate to the market is more likely to devise the optimal solution to a regulatory challenge or problem — one that is cost-effective and minimizes regulatory interference with sensitive market mechanisms. Proximity also reduces the risk of misaligning the performance incentives of regulatory personnel, avoiding the "small town speed trap" syndrome of police officers writing speeding tickets to fund municipal services rather than deter reckless driving.

The collegiality that arises from affiliation also reduces the "them versus us" mentality that prevents cooperative regulatory risk assessment and management. Affiliation also enhances the possibilities of career movement between the business side and the regulatory side, creating a regulator with market sensitivity and a business person who understands regulation. Finally, the affiliation of a regulator with an exchange focuses accountability for the direct and indirect costs that regulatory activities impose on the market: Neither the effectiveness nor the efficiency of regulation becomes "someone else's problem." These productivity and efficiency gains, in turn, benefit member organizations and other constituents that ultimately bear the costs of regulation.

Proximity also benefits the market participants being regulated. By taking early advice and input from the regulator, those being regulated can create a more effectively regulated environment by designing compliance and surveillance systems into their products and services. In this way, close regulatory proximity not only promotes better detection of regulatory issues, it also helps prevent these issues from arising in the first place. Self-regulation ensures that regulatory processes are not merely the result of delayed responses to new business developments. Rather, as an exchange or other market participant designs or evaluates new trading platforms, facilities, order types, products and services, the regulator can make clear at each stage of development the types of surveillance and audit trails that it will expect to review in relation to those new platforms, facilities, order types, products and services. Weighing surveillance and compliance needs and costs as part of a project's cost-benefit analysis, and building surveillance and compliance functionality into project design and development, is more likely to yield both regulatory soundness and cost effectiveness.

A recent example of the symbiotic relationship between the market and regulatory functions of an exchange is the NYSE's development of the NYSE Hybrid Market℠. The NYSE designed the hybrid market to improve its competitiveness, achieve the efficiencies demanded by its customers and comply with Regulation NMS. NYSE regulatory staff was integrally involved in the development process to ensure that, upon implementation of the hybrid market, NYSE Regulation would have the tools to properly regulate that platform. A "distant" regulator also could have vigorously regulated the hybrid market, but, by having NYSE Regulation involved in the development of the hybrid market from the outset, regulatory protections were designed into the platform.

Another example of the benefits afforded by the coordination of regulation with market functions is evident from the work of the NYSE Regulation's Member Firm Regulation ("*MFR*") division, which has primarily responsibility for the examination of member organizations for compliance with financial responsibility and sales practices rules. When MFR conducts an examination, its knowledge of the market, new technology developments and trading practices, as well as its coordination with market surveillance, allows it to effectively identify trading and financial control risk exposures and compliance failures.

Corporate and governance structures can reinforce self-regulatory budgetary and decision-making independence

Some commentators express a concern that self-regulation within a for-profit holding company structure that includes an affiliated market is problematic because the for-profit goals of a marketplace are always in direct conflict with the regulatory duties of that marketplace. The premise underlying this argument is false. In order to attract listing and trading on their platforms, stock exchanges must run a fair, well-regulated marketplace, or risk losing business. Companies list on a trading venue in part to associate themselves with the branding that comes from meeting high standards in a regulated environment. In addition, broker-dealers send their order flow to a trading venue to seek access to liquidity in a fair and orderly marketplace. A trading scandal or a poorly regulated market undermines investor confidence and erodes business at a stock exchange. As a result, NYSE Group has every incentive to ensure that the regulatory oversight of its listed companies, member organizations and trading platforms is robust.

Despite the clear business benefits that a stock exchange derives from efficient and effective regulatory processes, a for-profit environment may raise concerns that the public company might seek short-term gains from under-funding market surveillance or avoiding detection and disclosure of rule violation and regulatory lapses. However, by extending and enhancing the current functional separation of NYSE Regulation, and by insulating the regulatory budget and regulatory decision-making from the profit motive of the for-profit exchanges, the Proposed Rule Change addresses these concerns.

The insulation of the regulatory function of a self-regulatory organization is a core idea underlying Regulation SRO. The proposed corporate and governance structure of NYSE Group specifically complies with the proposed rules set forth in Regulation SRO, including with respect to the following:

- NYSE Regulation will be a separate not-for-profit entity within the overall NYSE Group structure;

- the Chief Executive Officer of NYSE Regulation will have the chief responsibility for the regulatory oversight of NYSE Group and its exchange subsidiaries, and will report solely to the NYSE Regulation board of directors;[6] and

- the regulatory fees, fines and penalties collected by NYSE Regulation may not be used for commercial purposes or distributed to any entity other than NYSE Regulation.

Appendix A to this letter contains a more detailed description of the ways in which the Proposed Rule Change complies with the principles and proposed rules of Regulation SRO.

In sum, we agree with the statement in Regulation SRO that "regulation is the most effective when it is done as closely as possible to the regulated activity."[7] Where appropriate, joint working groups of market and regulatory personnel can develop new products and services in a manner that will enhance long-term regulatory effectiveness. Similarly, closeness to the market will allow NYSE Regulation to identify trends that raise regulatory concerns and require particular focus from other divisions within NYSE Group.

A complete separation of NYSE Regulation from the rest of the NYSE would upset the balance that the Proposed Rule Change strikes between independence and market proximity, and undercut the very reason for self-regulation, at great cost to regulatory efficiency and effectiveness. Such a separation could reduce the knowledge and expertise of NYSE Regulation over time, and make it insufficiently sensitive to the market impact of its regulatory activities. Such a separation could also lead to increased costs because certain services, such as finance and human resources departments, would have to be duplicated. A complete separation could also reduce regulatory effectiveness and impose new costs by removing the integrated, cross-functional risk assessments and mitigation made possible by corporate affiliation, overlapping boards and a single internal audit function.

The Proposed Rule Change strikes an appropriate balance between preserving the benefits of self-regulation and protecting the regulatory independence and responsibilities of a national securities exchange. The NYSE's independent directors carefully and thoughtfully struck the balance embodied in the Proposed Rule Change based on their two years of experience overseeing the functional separation of NYSE Regulation from the NYSE's business by enhancing and extending the NYSE's current corporate governance structure to take into account the increased challenges posed by profit-maximization.

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[6] Nasdaq's criticisms in this area are especially curious since its Chief Regulatory Officer – who has responsibility for listing compliance and market surveillance – is permitted to report to Nasdaq's Chief Executive Officer.

[7] *See* Exchange Act Release No. 34-50699 (December 8, 2004).

2. The proposed governance structure of NYSE Group and its subsidiaries will protect the regulatory independence of New York Stock Exchange LLC and NYSE Regulation after the merger

Several of the comment letters argue that the Proposed Rule Change will not adequately protect the regulatory independence of New York Stock Exchange LLC and NYSE Regulation after the merger.[8] They set forth a variety of reasons for this conclusion, including that:

- members and member organizations of New York Stock Exchange will be permitted to own NYSE Group common stock and, as a result, will be able to have a significant influence on the composition of the boards of NYSE Group and its subsidiaries (including NYSE Regulation), which could disadvantage the trading public in favor of large member firms;

- the independent directors of NYSE Group will be a majority of members of the board of New York Stock Exchange LLC and "heavily represented" on the board of NYSE Regulation, and, therefore, New York Stock Exchange LLC and NYSE Regulation will be controlled by persons who have an incentive to maximize profits for NYSE Group rather than carry out the regulatory responsibilities of NYSE Regulation;

- under the Delegation Agreement, New York Stock Exchange LLC retains (as it is required to do under the Securities Exchange Act of 1934, as amended (the "*Exchange Act*")) ultimate responsibility for the operations, rules and regulations developed by NYSE Regulation, and the actions taken by NYSE Regulation pursuant to delegated authority remain subject to review, approval or rejection by the New York Stock Exchange LLC board of directors in accordance with procedures established by that board of directors (provided that action taken upon review of disciplinary decisions by the board of NYSE Regulation shall be final action of New York Stock Exchange LLC); and

- the NYSE's rule proposal does not provide enough detail regarding the funding of NYSE Regulation and, therefore, does not address the issue of whether NYSE Regulation will have adequate funding.

The NYSE disagrees with these arguments, and respectfully submits that the checks and balances that the proposed governance structure of NYSE Group and its subsidiaries embodies will protect the regulatory independence of New York Stock Exchange LLC and NYSE Regulation after the merger.

[8] *See* letter from the Investment Company Institute, dated February 2, 2006; letter from the Securities Industry Association and the Bond Market Association, dated February 2, 2006; letter from CalPERs, dated February 2, 2006; letter from the Independent Broker Action Committee, Inc., dated February 2, 2006; and letter from Nasdaq, dated February 2, 2006.

No particular NYSE member organization will have undue influence on NYSE Group or its subsidiaries

As described in the Proposed Rule Change, under the proposed NYSE Group certificate of incorporation, no person (either alone or together with its related persons) will be entitled to (1) vote more than 10% of the total number of votes entitled to be cast on any matter or (2) beneficially own shares of stock of NYSE Group representing in the aggregate more than 20% of the then outstanding votes entitled to be cast on any matter. Under the proposed certificate of incorporation, NYSE Group shall disregard any votes purported to be cast in excess of the voting limitation, and will be obligated to purchase any shares held in excess of the ownership limitation. The NYSE Group board of directors may not waive these voting and ownership limitations above the 20% threshold for any person that is a member or member organization of New York Stock Exchange LLC. Moreover, before the NYSE Group board of directors may waive any voting and ownership limitation, it must determine that the exercise of such voting rights or ownership by such person will not impair the ability of NYSE Group or its regulated subsidiaries from discharging their respective responsibilities under the Exchange Act, and any such waiver must be passed by a resolution filed and approved by the SEC under Section 19 of the Exchange Act.

The NYSE respectfully submits that these limitations on the concentration of voting power and ownership of NYSE Group stock will ensure that no member organization or other stockholder will exert undue influence on the NYSE Group or its subsidiaries, including NYSE Regulation.

The presence of NYSE Group directors on the boards of New York Stock Exchange LLC and NYSE Regulation will not jeopardize the regulatory independence of NYSE Regulation

Pursuant to the Delegation Agreement, New York Stock Exchange LLC will delegate its regulatory responsibilities and functions to NYSE Regulation. Every director of NYSE Regulation (other than the Chief Executive Officer of NYSE Regulation) will be independent of broker-dealers, New York Stock Exchange-listed companies and management of NYSE Group. In addition, a majority of the directors of NYSE Regulation must be persons who are not directors of NYSE Group. These requirements will insulate NYSE Regulation from the for-profit interests of NYSE Group and from the interests of the other entities and persons that NYSE Regulation will regulate.

The presence of NYSE Group directors on the boards of the directors of New York Stock Exchange LLC and NYSE Regulation does not change this conclusion. The NYSE Group directors on the NYSE Regulation board will comprise only a minority of the NYSE Regulation board and, therefore, by themselves will not be able to control any decision of NYSE Regulation. Moreover, each of the NYSE Group directors on the NYSE Regulation board must be independent (including independent from the management of NYSE Group). Furthermore, at least 20%, and no less than two, of the directors of NYSE Regulation will be selected from the "fair representation" candidates through the process described in the purpose section of the Form 19b-4 filing.

The independence requirement for directors will also apply to New York Stock Exchange LLC. Each director of New York Stock Exchange LLC must be independent of broker-dealers, New York Stock Exchange-listed companies and management of NYSE Group. In addition, similar to the NYSE Regulation board, at least 20%, and no less than two, of the directors of New York Stock Exchange LLC will be selected from the "fair representation" candidates. New York Stock Exchange LLC will delegate its self-regulatory responsibilities pursuant to the Delegation Agreement to NYSE Regulation, whose board will consist of a majority of directors who are not NYSE Group directors. New York Stock Exchange LLC's retention of ultimate responsibility for the operations, rules and regulations developed by NYSE Regulation reflects the practical necessity of creating a license holding company to enable the separately incorporated NYSE Market and NYSE Regulation to share a single exchange registration. However, as an operational matter, all of the regulatory responsibilities NYSE Group will be carried out by NYSE Regulation, which will be subject to the oversight and review of the SEC.

There is minimal risk that New York Stock Exchange LLC will inhibit the regulatory functions of NYSE Regulation in favor of the for-profit interests of NYSE Group. With respect to compensation matters, NYSE Regulation will have a separate compensation committee appointed by the NYSE Regulation board of directors, which will provide NYSE Regulation with the responsibility and authority to assure the competence and proper compensation of its regulatory staff. A majority of the members of this compensation committee must be persons who are not directors of NYSE Group. With respect to the nominating and governance matters, NYSE Regulation will have a separate nominating and governance committee, and New York Stock Exchange LLC, as the sole member of NYSE Regulation, will be required to elect, as a majority of the board, persons who are not directors of NYSE Group or otherwise affiliated with NYSE Group. As with the compensation committee, majority of the members of this nominating and governance committee must be persons who are not directors of NYSE Group. With respect to disciplinary matters, any disciplinary decision of the NYSE Regulation board of directors shall be deemed to be the final action of New York Stock Exchange LLC and not subject to its review or approval. In addition, with respect to the promulgation of rules and regulations, any proposed changes to them must be published in the *Federal Register* and will be subject to the comment and SEC approval process prescribed by Section 19 of the Exchange Act. Moreover, the SEC has plenary oversight responsibility of all of NYSE Regulation's regulatory responsibilities, and is the final arbiter of any question regarding NYSE Regulation's rulemaking, examination or disciplinary actions. Finally, the Chief Executive Officer of NYSE Regulation will report solely to the NYSE Regulation board of directors and will not be an officer or director of NYSE Group or New York Stock Exchange LLC. In sum, there is little risk that NYSE Regulation's independence will be jeopardized by the fact that New York Stock Exchange LLC retains ultimate responsibility for the operations, rules and regulations developed by NYSE Regulation. This is especially true given that the New York Stock Exchange LLC board understands that the public and the SEC will be scrutinizing its conduct in this regard. New York Stock Exchange LLC's statutorily dictated responsibilities, therefore, will in no way supplant or nullify the good-faith regulatory activities or judgment of NYSE Regulation.

The Proposed Rule Change states explicitly that adequate funding will be provided to NYSE Regulation

As outlined in the purpose section of the Form 19b-4 filing for the Proposed Rule Change, NYSE Regulation will determine, assess, collect and retain for regulatory purposes regulatory fees and fines. As is currently the case, a large portion of NYSE Regulation's revenues will be derived from fees paid by member organizations as a percentage of their gross revenues. NYSE Regulation does not anticipate any significant changes to these fees. New York Stock Exchange LLC and NYSE Market will also be directly responsible for the costs of floor-related market surveillance and related disciplinary support services and listing compliance review. New York Stock Exchange LLC and NYSE Market will enter into a contractual agreement with NYSE Regulation to provide this funding to NYSE Regulation. The Pacific Exchange (which, together with its affiliates, will be renamed NYSEArca after the merger) will enter into a similar services agreement with NYSE Regulation. The payments made by New York Stock Exchange LLC, NYSE Market and NYSEArca to NYSE Regulation under these agreements may by funded in part by listing fees and market data fees, assuring that listed companies and institutional investors, respectively, help fund the costs of those services. NYSE Regulation will also collect regulatory fines from persons who violate the rules and regulations of NYSE Regulation, NYSE Market and NYSEArca.[9] Under the operating agreement of New York Stock Exchange LLC, New York Stock Exchange LLC will be prohibited from using any of these regulatory fees, fines or penalties for commercial purposes. Moreover, because NYSE Regulation is a New York not-for-profit corporation, NYSE Regulation may not distribute these fees and fines in the form of a distribution or dividend to New York Stock Exchange LLC except in a liquidation or certain other extraordinary circumstances.

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[9] The Bond Market Association, the Securities Industry Association and the Independent Broker Action Committee contend that the Proposed Rule Change should set forth more detail regarding these funding arrangements. The Bond Market Association and the Securities Industry Association specifically propose that Proposed Rule Change should provide that the regulatory funding should be based on (i) fees paid by members; (ii) a portion of listing fees and trading fees paid by other market constituents that receive the benefit of regulatory oversight or broker-dealers and the various examinations and continuing education; and (iii) contractual agreements for regulatory services to other self-regulatory organizations ("*SROs*"), and that NYSE Regulation should exclude from its funding formula market data fees or any other fees charged for specific services or products. The NYSE notes that the SEC has approved comparable funding arrangements to those described in the Proposed Rule Change in connection with the provision by the NASD of regulatory services to Nasdaq, the American Stock Exchange and the International Securities Exchange. *See*, *e.g.*, Exchange Act Release No. 34-53128 (January 13, 2006) (Nasdaq); Exchange Act Release No. 34-50122 (July 29, 2004) (American Stock Exchange); Exchange Act Release No. 34-42455 (February 24, 2000) (International Securities Exchange). The NYSE respectfully submits that the NYSE is not distinguishable in this regard from those markets.

3. The proposed governance structure of New York Stock Exchange LLC, NYSE Market and NYSE Regulation provide fair representation for the members of New York Stock Exchange LLC

The Bond Market Association and the Securities Industry Association contend (and the Nasdaq suggests) that the proposed governance structure of New York Stock Exchange LLC, NYSE Market and NYSE Regulation fails to meet the requirement of fair representation under Section 6(b)(3) of the Exchange Act, which requires that "[t]he rules of the exchange assure a fair representation of its members in the selection of its directors and administration of its affairs." The Bond Market Association, the Securities Industry Association, the Investment Company Institute and the Independent Broker Action Committee argue that the boards of directors of New York Stock Exchange LLC and NYSE Regulation should include representatives who are investors, and that such inclusion may be required in order to satisfy the "fair representation" requirements of the Exchange Act. The Bond Market Association and the Securities Industry Association also argue that broker-dealer members should be members of the nominating and governance committee and the audit committee of each of New York Stock Exchange LLC, NYSE Market and NYSE Regulation, as well of the standing committees responsible for rulemaking and for assessing the adequacy and effectiveness of regulatory programs.

The NYSE disagrees. While these commentators recognize the competitive necessity for the NYSE to demutualize and the need to mitigate the pressures on the independence of NYSE Regulation that profit-maximization introduces, they give short shrift to the perennial pressures on regulatory independence that arise from the "fox in charge of the chicken coop" conundrum presented by the very nature of self-regulation. The presence of member organization executives on the board of an entity charged with regulating those member organizations raises potential conflicts of interest that can interfere with effective regulation. The NYSE learned this lesson and, in 2003, restructured its board from a constituent assembly into a corporate-type board comprised of directors wholly independent from those that it regulates. This restructuring made it possible for the NYSE board to play the strategic and control roles for NYSE Regulation that Sarbanes-Oxley and the NYSE's governance requirements demand of every public company. The subsequent two years have been marked by the pervasive engagement of the NYSE independent directors, through the board's Regulatory Oversight Committee, with the "business" of NYSE Regulation.

These commentators point to no evidence to support their concerns that NYSE Regulation is out of touch with the market as a result of the NYSE's requirement of independent directors. The NYSE's current Board of Executives, Market Performance Committee, Compliance Advisory Committee and other standing and *ad hoc* committees (all playing solely advisory roles) have provided the crucial direct involvement in developing funding and rule proposals and in addressing operational issues. Constituent representation on the NYSE Market and NYSEArca boards, the continuing role of the Market Performance Committee, the Compliance Advisory Committee and other advisory committees, and the creation of a Regulatory Advisory Committee will carry this constituent involvement forward into the NYSE's new structure. The NYSE has learned from its governance

restructuring that this form of director independence is the touchstone of effective self-regulation.

Direct involvement of constituents in the selection of our independent directors is another matter. Apart from the many informal ways in which our constituents can suggest director candidates, the NYSE has proposed that member organizations of New York Stock Exchange LLC select at least 20%, and no less than two, of the directors of the boards of the New York Stock Exchange LLC and its two operating subsidiaries. The selection process will occur through a combination of action by the Director and Candidate Recommendation Committee (the "*DCRC*") of NYSE Market and NYSE Regulation, which DCRC will be comprised of member organization representatives, and a petition process, in each case as described in the Proposed Rule Change. This mechanism is a straightforward extension of the process that the NYSE adopted in 2003, with the DCRC replacing the industry members on the Board of Executives in making recommendations for "fair representation" candidates.

This proposed structure not only carries forward the NYSE's current governance structure, which requires that each director of the NYSE be independent from constituents, but also complies with the SEC's proposed rules regarding fair representation.

In 2003, when the NYSE proposed its current board structure, some commentators questioned whether a requirement of a fully independent board satisfied the fair representation requirements of Section 6(b)(3). In its order approving the NYSE's current structure, the SEC responded as follows:

> Recent events at the Exchange have called into question whether its Board of Directors and key Board committees have been sufficiently independent from NYSE management to assure that these governing bodies exercise their judgment in an objective and autonomous manner. The Exchange quickly confronted its governance issues by appointing an Interim Chairman, without any ties to the Exchange, and by proposing amendments to its Constitution that would significantly alter its governance structure. Moreover, the Exchange has proposed changes to its Constitution that are designed to assure the independence of its regulatory unit from NYSE management and from the entities that it regulates. At the same time, the NYSE has created a mechanism of nomination to the Board of Directors designed to fulfill the "fair representation" requirements applicable to national securities exchanges, as set forth in Section 6(b)(3) of the Act.[10]

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[10] *See* NYSE Rulemaking: Order Approving Proposed Rule Change Relating to the Amendment and Restatement of the Constitution of the Exchange to Reform the Governance and Management Architecture of the Exchange, Securities and Exchange Commission (Release No. 34-48946; File No. SR-NYSE-2003-34), December 17, 2003, p. 74685.

Furthermore, in Regulation SRO, the SEC exhibited its continuing support for the NYSE's board structure when it proposed rules that mirrored those of the NYSE:

> Consistent with the fair representation requirement, the proposed governance rules would require that the Nominating Committee administer a fair process that provides members with the opportunity to select at least 20% of the total number of directors ("member candidates"). This requirement is not intended to prohibit exchanges and associations from having boards composed solely of independent directors. If an exchange's or association's board is composed wholly of independent directors, the candidate or candidates selected by members would have to be independent. This "20% standard" for member candidates comports with previously-approved SRO rule changes that raised the issue of fair representation.[11]

Furthermore, Regulation SRO included a requirement that:

> exchanges and associations . . . adopt rules to establish a fair process for the nomination of alternative candidates by members through a petition process. This requirement would provide members with the means to nominate one or more alternative candidates representative of members. The percentage of members that is necessary to put forth such alternative member candidate or candidates would be required to be specified in the exchange's or association's rules, and could not exceed 10% of the total number of members.[12]

In compliance with the proposals set forth in Regulation SRO, the member organizations of New York Stock Exchange LLC will have the right to nominate candidates by petition to the boards of directors of New York Stock Exchange LLC, NYSE Market and NYSE Regulation.[13] In order for a member organization to nominate a candidate by petition, such

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[11] Self-Regulatory Organizations – Various Amendments; Proposed Rule. Securities and Exchange commission (Release No. 34-50699; File No. S7-39-04), Federal Register, Vol. 69, No. 235, December 8, 2004, p. 1137. *See* Exchange Act Release No. 34-48946, *supra* note 10 (approving the "20% standard" for the NYSE); Self-Regulatory Organizations; Pacific Exchange, Inc.; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 1 Thereto Relating to the Demutualization of the Pacific Exchange, Inc. Securities and Exchange Commission (Release No. 34-49718; File No. SR-PCX-2004-08, Federal Register, Vol. 69, No. 100, May 17, 2004 (approving the "20% standard" for the Pacific Exchange).

[12] *See* Self-Regulatory Organizations – Various Amendments; Proposed Rule. Securities and Exchange commission (Release No. 34-50699; File No. S7-39-04), Federal Register, Vol. 69, No. 235, December 8, 2004, p. 1137.

[13] The Bond Market Association and the Securities Industry Association note that, under the Proposed Rule Change, certain directors of NYSE Market must meet the "status or constituent affiliation qualifications prescribed by NYSE Market rule or policy", and then assumes that these qualifications refer to the qualifications that applied to member directors of the NYSE before 2003. The NYSE notes that its reference

candidate must be endorsed by a number of signatures equal to at least ten percent (10%) of the signatures eligible for such candidate.

The NYSE therefore disagrees with the comments that the independence requirements of the New York Stock Exchange LLC board of directors and the NYSE Regulation board of directors fails to comply with the "fair representation" requirements of the Exchange Act. These matters have already been addressed by past SEC releases and orders.[14]

4. NYSE Market should be responsible for the operation of Market Watch

Nasdaq suggests that it may not be appropriate for NYSE Market to operate Market Watch, a unit whose functions include, among others, coordination with listed companies, floor officials and regulatory staff of NYSE Regulation with respect to dissemination of news and trading halts.

The NYSE disagrees with Nasdaq's suggestion. Market Watch's duties are primarily informational, not regulatory, in nature. Market Watch focuses on disseminating news and trading halts among listed companies, floor officials and regulatory staff. NYSE Market is in the best position to provide this service because NYSE Market will operate the exchange on which trading takes place.[15]

NYSE Regulation, on the other hand, will be in charge of the Stock Watch unit, which will be responsible for reviewing exception reports, alerts and investigations. NYSE Regulation will therefore remain ultimately responsible for regulatory enforcement.

to such qualifications in the Proposed Rule Change as are filed with the SEC, and the NYSE does not have any additional proposed qualifications filed with the SEC at this time.

[14] The Bond Market Association and the Securities Industry Association also contend that the recommendation process for the "fair representation" candidates is unclear, and that the process does not address what happens if the NYSE Market DCRC and the NYSE Regulation DCRC disagree on the "fair representation" candidates for the New York Stock Exchange LLC board of directors. The NYSE respectfully submits that the recommendation process is clearly outlined in the Proposed Rule Change. Moreover, as a practical matter, there will be no conflicts between the NYSE Market DCRC and NYSE Regulation DCRC in recommending "fair representation" candidates for New York Stock Exchange LLC because the NYSE Market DCRC and NYSE Regulation DCRC will act as one committee in making those recommendations, and, as noted in the purpose section of the Form 19b-4 filing for the Proposed Rule Change, the NYSE expects that the two committees will be comprised of the same persons.

[15] The NYSE finds Nasdaq's suggestion particularly surprising because the NYSE understands that Nasdaq, not the NASD, performs the analogous function for its market.

5. The decision as to whether and how the broker-dealer regulatory functions of the NYSE and the NASD should be consolidated is not related to the merger, and, therefore, the NYSE should not be required to commit to this consolidation as part of the Proposed Rule Change

The Bond Market Association, the Securities Industry Association and Nasdaq argue that the regulation of broker-dealers conducted by NYSE Regulation and the National Association of Securities Dealers ("*NASD*") should be consolidated. The Bond Market Association and the Securities Industry Association also request that, as a condition to its approval of the NYSE's Proposed Rule Change, the SEC require the NYSE to affirmatively commit to work with the NASD to develop, within a set timeframe (such as 60-90 days from the date of the approval of the Proposed Rules Change), recommendations and an implementation timetable for the consolidation of the broker-dealer regulatory functions of the NYSE and the NASD. Nasdaq goes further and requests that the SEC insist that the NYSE "rationalize inconsistent and duplicative regulation now" and not after the merger.

The NYSE has for some time taken the position that it may be in the best interest of investors if the regulatory oversight of broker-dealers of the NYSE and NASD were harmonized, and if the NYSE and NASD entered into a joint venture or other cooperative relationship (where the NYSE and NASD would each retain substantial regulatory responsibility) to reduce duplications in the regulatory process.[16] However, the NYSE and the NASD have not reached an agreement with each other (let alone with the SEC) as to when and how this harmonization and/or cooperative relationship should be effected. The NYSE respectfully submits that these decisions are not related to the Proposed Rule Change, and need not be decided in this rulemaking.

Currently, the NYSE and the NASD separately regulate broker-dealer activities. The consummation of the merger of the NYSE and Archipelago will not change this fact. The SEC, the NYSE and the NASD may determine that their regulatory oversight of broker-dealers should be rationalized in some manner, and agree on a plan for this rationalization, but this decision does not need to be linked to the decision as to whether the merger can be completed. This is particularly true given that any joint venture effort could raise conflict issues. For example, although the NASD may have eliminated its ownership relationship with Nasdaq and the American Stock Exchange, the NASD will continue to receive substantial funds through its regulatory service contracts with Nasdaq, the American Stock Exchange and the International Securities Exchange. Moreover, as part of Nasdaq's efforts to become an exchange, the NASD and Nasdaq are seeking approval of an extraordinary reciprocal arrangement relating to the operation of trade reporting systems and the recapture of tape fees by Nasdaq. The NYSE does not suggest that this arrangement should disqualify the NASD from providing regulatory services to Nasdaq, but the NYSE

[16] *See, e.g.*, Speech of John A. Thain at the Annual Meeting of the Securities Industry Association on November 10, 2005.

believes that they demonstrate that no self-regulatory organization today operates without conflicts, and that there are complicated issues involved with any joint regulatory venture.

Moreover, the decision as to whether and how any joint venture should take place requires the involvement of both the NYSE and NASD. An affirmative commitment on the part of the NYSE alone, extracted as the price of consummating the merger, is like one hand clapping — it would not be effective unless both the NYSE and NASD made the same commitment and could agree on the need for and manner of the joint venture.

As the Securities Industry Association and the Bond Market Association noted in their comment letter, "senior staffs of both the NYSE and NASD have recently shown a strong commitment to work together to eliminate unnecessary duplication and conflict."[17] In addition, as part of the Proposed Rule Change, the NYSE has committed that it will use its best efforts, in cooperation with the NASD, to submit to the SEC, within one year of the approval of the Proposed Rule Change, a report disclosing any inconsistencies between the rules of the NYSE and the NASD relating to the regulation of broker-dealers, and will submit changes reconciling these inconsistencies. The NYSE invites the SEC to participate in its continuing discussions with NASD regarding a possible joint venture of their regulatory programs.

6. Trading Licenses will provide fair access to NYSE Market

The Independent Broker Action Committee contends that the Proposed Rule Change would hamper the ability of floor brokers to participate in future auctions for Trading Licenses, thus burdening competition in the market for access to trading rights. Essentially, the Independent Broker Action Committee expresses the fear that others, namely specialists, would have better business opportunities under the proposed NYSE Hybrid Market[SM], allowing them to expand their presence at the New York Stock Exchange, and thereby increasing the price of a Trading License at the annual auction to a point where the floor brokers would not find it economical to purchase a Trading License.[18] The Committee's proposed solution is to (1) cap the price at each annual auction going forward at no more than 20% above the prior year's auction price, (2) separately assure existing license holders the ability to acquire a license in the next auction, and (3) more strictly limit the potential concentration of Trading Licenses than does the present Proposed Rule Change.[19]

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[17] *See* letter from the Securities Industry Association and the Bond Market Association, dated February 2, 2006.

[18] The Independent Broker Action Committee's comments are largely directed at the NYSE's separate hybrid market proposal. As that is a separate proposal, responses to those comments will be made separately.

[19] The NYSE also notes that the Independent Broker Action Committee claimed that the NYSE's plans to conduct the auction prior to SEC approval of the auction rules was a violation of the Exchange Act, and one that "skews the entire comment process." As the NYSE noted in Item 5 of the NYSE-2005-77, the NYSE believed that the Independent Broker Action Committee would not be in any way prejudiced in its ability to

It is important to realize that the economic impact that the Independent Broker Action Committee fears is one that could befall them today in the seat lease market. Nothing about the proposed mechanism to auction annual Trading Licenses will increase their economic exposure beyond what it is today. Indeed, the Proposed Rule Change includes limitations on existing firms' ability to acquire greater numbers of Trading Licenses, which limitations do not exist in the current lease market. In that respect, the members of the Independent Broker Action Committee have greater protection under the Proposed Rule Change than they do today.

The NYSE has set forth in the purpose section of the Form 19b-4 filing the reasons why the procedures under which Trading Licenses will be made available are calculated to comply with the requirements of Section 6(b)(2) of the Exchange Act regarding fair access to the facilities of a registered exchange, as well as why those procedures comply with the requirements of Section 6(b)(4) of the Exchange Act, which requires that a registered exchange provide for the equitable allocation of reasonable dues, fees, and charges among its members and issuers and other persons using its facilities. Without repeating that analysis in full in this response, a central ingredient in each part of the analysis is that the modified Dutch auction is an intrinsically fair process by which to allocate Trading Licenses, and essentially similar to the way in which membership access to the NYSE has been allocated for many years. The Independent Broker Action Committee suggests that most of its members lease, rather than own, NYSE memberships. The typical term of a NYSE lease is one year, so lessees find themselves each year in negotiation with their lessors regarding the price to be paid for the coming year. To the extent that any particular type of member organization enjoyed greater business success and wished to expand its number of memberships, there would be economic pressure on the finite supply of seats, and lease prices would rise. A lessee has no assurance that he or she will be able to lease a seat in the future, and certainly no assurance that he will immune from price increases that he might find difficult to pay.

There is no statutory reason why the NYSE should now be required to immunize any particular type of user against the vicissitudes of the market. In connection with the first auction in contemplation of the merger, the NYSE included a maximum bid price (which was 120% of the recent average annual lease price) in order to ease any concerns of existing NYSE members given the potentially significant changes to business models that may evolve this coming year. In future years, NYSE Market may find it advisable to respond to other circumstances affecting those likely to be interested in holding Trading

comment if the NYSE were to conduct the auction process prior to SEC approval of the auction rules, and that conducting the first auction provisionally would give members and others as much certainty as possible as early as possible to plan for post-merger business, as well as providing both the SEC and the NYSE with the opportunity to observe whether the auction procedures resulted in a fair and orderly pricing of the Trading Licenses and fair access to the facilities of the NYSE. Assuming SEC approval of the Proposed Rule Change, the desired certainty regarding the price for Trading Licenses in the first year has in fact been obtained, and the mere existence of the Independent Broker Action Committee's January 31, 2005 letter has amply demonstrated that people's ability to comment on the Proposed Rule Change was not prejudiced.

Licenses. Such economic negotiations are an expected part of a market economy. Although the Exchange Act requires fairness in providing and charging for access, it does not entitle anyone or any group to special treatment or economic protection.

A separate comment on Trading Licenses was contained in the joint letter of the Securities Industry Association and the Bond Market Association. They note that, as proposed, each Trading License is a full license to have access to all facilities of NYSE Market. They state that many smaller broker-dealers concentrating their business on the markets for debt securities do not also trade equities and are therefore not interested in obtaining a full Trading License. They indicate that such dealers will be presented with the choice of either applying for equity trading rights that they do not need, or not obtaining direct access to the NYSE Market's Automated Bond System. They state that the New York Stock Exchange should be required to make provision for "fair access" to debt dealers who are not also equity dealers.

We note that the nature of the access provided to each holder of a Trading License is the same as the full access afforded to each member today. In that respect, the Proposed Rule Change involves no change, and those smaller debt dealers presumably do not pay to own or lease NYSE memberships today. As a reason why they may have a greater interest in the future, the Securities Industry Association and the Bond Market Association note that the NYSE has a pending application for exemptive relief to trade unlisted debt securities on the Automated Bond System.

When NYSE Market is finally able to trade unlisted debt of listed companies, as contemplated in the exemptive application, its share of the overall bond market trading can be expected to increase from the estimated less than one-half of one percent that it represents today. And if this increases interest among debt-only broker-dealers in obtaining direct access to the Automated Bond System, NYSE Market will undoubtedly be desirous of determining how that direct access can provided with fairness to those debt dealers, NYSE Market, and the other participants in the market for debt securities. As noted by the Securities Industry Association and the Bond Market Association in its comment letter, the NYSE has said that it may decide in the future to issue separate licenses for electronic only access or access limited to particular products. The NYSE has talked publicly about the potential for NYSE Market to become a trading venue for other products, and each such development brings with it the need to determine how best to afford access to the customers that one hopes will desire it. Until now, however, the current need to obtain a full membership to gain access to the Automated Bond System does not seem to have been an issue for the smaller debt-only broker dealers that the comment letter describes. Accordingly, the NYSE believes that there is no deficiency in the fair access provided by the Trading Licenses as they are currently structured.

7. Market data has been the subject of recent SEC review, and decisions relating to market data fees are not related to the Proposed Rule Change

The Securities Industry Association and the Bond Market Association assert that the Proposed Rule Change does not provide appropriate treatment of market data.

Specifically, they contend that: (1) market data fees should be cost-based; (2) the proceeds from market data fees should not be used to fund other exchange activities, particularly regulation; (3) member organizations should be represented in the setting of market data fees; and (4) SRO status conveys a lucrative monopoly on depth-of-book data that is an unjustifiable government subsidy to a profit-making entity. The NYSE respectfully disagrees with each of these assertions.

The NYSE believes that the current market-based process for determining data fees should be preserved, and that imposing a strict cost-based formula is inadvisable. In 1975, Congress declined to impose cost-based pricing in favor of "fair and reasonable" standards and public comment and oversight over data fees. Most industry participants, including most of those who participated during 2000 and 2001 in the "Seligman Committee," also supported the market-based approach, and stated that "a cost-based approach is both unnecessary and impractical."

The NYSE disagrees with the view that market data fees should not be used to fund other exchange activities. Markets have long used data fees as one means to fairly allocate the cost of market activities to market participants. The NYSE should be permitted to defray some of the listing compliance and market surveillance costs of NYSE Regulation with the market data fees charged by NYSE Market and NYSEArca, as part of its commitment to ensure that NYSE Regulation is adequately funded to accomplish its regulatory mandate.

The NYSE agrees with the Securities Industry Association and Bond Market Association that exchange constituents should continue to have input into the determination of market data and other fees, which is one reason that the NYSE favors a market-based rather than cost-based approach for market data fees. As noted above, the Proposed Rule Change carries forward committee structures that have long effected that process.

The NYSE disagrees that SRO status conveys an improper monopoly over depth of book data that, with demutualization, will amount to an unjustified subsidy to a profit-making entity. Each of the nine members of the Consolidated Tape Association is capable of providing its own depth-of-book data products, competing directly with the NYSE and the other members of the association. In adopting Regulation NMS, the SEC made clear that an exchange may distribute proprietary data products subject to "fair and reasonable" standards with respect to fees.

Many of the issues raised by the Securities Industry Association and Bond Market Association were considered by the SEC in formulating, proposing and adopting Regulation NMS. The SEC solicited widespread industry input in connection with this regulatory initiative and arrived at carefully considered policy decisions based on an enormous volume of thoughtful feedback from market participants. The NYSE respectfully submits that revisiting those policy decisions at this time, only months after Regulation NMS was finally adopted and through the prism of a particular transaction rather than industry-wide reform, would be premature and, in any event, that decisions

about SRO funding are not related to the Proposed Rule Change and need not be decided in this rulemaking.

8. The Proposed Rule Change adequately addresses the rights of holders of options trading rights

Addressing the rights of holders of option trading rights ("*OTRs*"), Andrew Rothlein, Michael Wallach, Gregory Tenbekjian, Ken Marks, Pamela Rothlein, Enid Wallach and Mary Ann May (the "*OTR Commentators*") argue that certain OTRs issued by the NYSE (namely, those OTRs that have been separated from their underlying NYSE memberships) are not treated properly in the Proposed Rule Change because they (along with all OTRs) will be extinguished in the merger without conferring their holders with any rights or benefits after the merger.

The NYSE disagrees. As the OTR Commentators concede, OTRs do not represent equity interests in the NYSE. Instead, OTRs are limited rights to physically enter the NYSE trading floor for the purpose of trading options admitted to dealings on the NYSE.[20] OTRs, like all NYSE trading rights, will be cancelled in the merger.

The OTR Commentators argue that an OTR carries the unfettered right "to trade all options under the auspices of the NYSE or its successor," whether by merger, acquisition or both. The specific wording of the NYSE's Constitution describing OTRs refutes this contention.[21] In addition, no options are currently traded on the NYSE, and no options will be traded on NYSE Market immediately after the merger. The only entity affiliated with New York Stock Exchange LLC immediately after the merger that will trade options will be NYSEArca, which is not a successor to the NYSE and will be an entity separate from New York Stock Exchange LLC, with its own rules, regulations, qualifications, filings and requirements for options trading. There will be neither physical entry upon NYSE Market's trading floor to trade options nor any options admitted to dealing on NYSE Market. Thus, none of the operative conditions of an OTR is met.

If a person wishes to trade options through NYSEArca's facilities, he or she can do so by meeting NYSEArca's requirements and paying the appropriate fees, which are currently approximately $1,850.

The OTR Commentators discuss the anticipated benefits to OTR holders in connection with the NYSE's transfer of its options business to the Chicago Board Operations Exchange ("*CBOE*"). The NYSE disclosed and explained any potential benefits to OTR holders from this transaction in its filing with the SEC on Form 19b-4 dated February 28, 1997 (SR-NYSE-97-05) and Amendment No. 1 thereto (the "*OTR Filing*"), which filing

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[20] *See* NYSE Constitution, Article 1, Section 8.

[21] *Id.*

was approved by the SEC on April 23, 1997.[22]

The OTR Commentators assert that the terms of the OTR Lease Pool, an arrangement designed to benefit OTR holders such as the OTR Commentators, were not fully known to participants. However, the OTR Filing fully disclosed these terms: The NYSE specifically described the creation of a Lease Pool arrangement pursuant to which certain CBOE trading permits would be leased out for a period of 7 years, with the proceeds from the leases to be distributed pro rata to the approximately 92 persons who, as a result of their OTRs, were entitled to the possible benefits discussed in the OTR Filing. The concept of compensating certain OTR holders was approved by the NYSE's board of directors, communicated to NYSE members by means of a special membership bulletin dated September 6, 1996, discussed at length and with specifics in both the OTR Filing and the SEC's approval order, and approved by the SEC in its approval order. In connection with its approval of the Lease Pool concept, the SEC stated in Section IV of its approval order that it "believes that the established limit on Permits, the manner in which they are to be distributed, and the lease pool program, are all reasonable provisions."[23] Moreover, as the NYSE noted in Section 3.A.(vi) of the OTR Filing, with respect to separated OTRs, "all OTRs . . . will have only speculative value at the conclusion of the transfer."

The NYSE made every effort consistent with sound business practices to maximize benefits to OTR holders, notwithstanding the absence of any obligation to do so. As the SEC explained in Section IV of its approval order:

> The Exchange conducted a careful assessments [sic] and review of its options business and determined that it no longer wished to continue this business. There is nothing in the [Exchange] Act that compels the NYSE to continue to trade a particular product line. Moreover, the NYSE is permitted to terminate the options business entirely . . . . Rather than simply terminate its options business, the NYSE attempted to package its options business as a whole and attempted to transfer it to another exchange in return for certain privileges accruing to NYSE options members . . . . [T]he Commission believes that the NYSE has made reasonable efforts to achieve a solution that has maximized the value of the NYSE Options program.[24]

The NYSE's records indicate that each of the OTR Commentators was among the 92 holders of those OTRs that the Lease Pool was designed to benefit. The NYSE understands from the CBOE that all requisite Lease Pool payments were made. By their

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[22] *See* Exchange Act Release No. 34-38542 (April 23, 1997).

[23] *See id*.

[24] *Id*.

own admission in their comment letter, the OTR Commentators appear to have received from the Lease Pool more than four times the aggregate revenue that they could have expected to receive from leasing their OTRs for use on the NYSE.[25] Their attempt to compare this substantial increase in lease revenue to other standards, such as the value of a regular CBOE Trading Permit, is simply inapposite. Thus, it appears that the OTR Commentators already have received in connection with their OTRs any compensation that was contemplated as possible from those OTRs in connection with the CBOE transaction. The NYSE is aware of no representations from any source as to other compensation for or potential benefit from such OTRs.

In sum, the NYSE respectfully submits that the OTRs are not being treated in an "unfair" manner in the merger. As the OTR Commentators concede, the OTRs are not equity interests in the NYSE and, therefore, are not entitled to merger consideration or any other benefits that the OTR Commentators seek to obtain.

* * *

Thank you for your consideration of these responses. We would be pleased to answer any questions or provide further information that you may find helpful.

Sincerely,

Mary Yeager
Assistant Secretary

cc: Chairman Christopher Cox
Commissioner Paul S. Atkins
Commissioner Roel C. Campos
Commissioner Cynthia A. Glassman
Commissioner Annette L. Nazareth
Mr. Robert L.D. Colby

[25] *See* letter from Andrew Rothlein, Michael Wallach, Gregory Tenbekjian, Ken Marks, Pamela Rothlein, Enid Wallach and Mary Ann May, dated December 23, 2005 (information after asterisk on page 6).

APPENDIX A

This Appendix describes the way in which the Proposed Rule Change complies with the principles and the proposed rules of Regulation SRO:

- *Structural Separation of Regulation*. Regulation SRO provides that an exchange's regulatory program should be either structurally separated from the exchange's market operations and other commercial interests by means of separate legal entities, or functionally separated within the same legal entity from the exchange's market operations and other commercial interests. As set forth in the Proposed Rule Change, NYSE Group plans to implement the alternative of full legal separation, with its regulatory operations to be conducted in NYSE Regulation and its market operations to be conducted by NYSE Market and NYSEArca. NYSE Regulation is a separate not-for-profit entity within the overall NYSE Group structure. In addition, NYSE Regulation will have a separate board of directors, and each member of NYSE Regulation board of directors (other than the Chief Executive Officer of NYSE Regulation) must satisfy requirements for independence from management, listed companies and member organizations. A majority of the NYSE Regulation directors will also have to be persons who are not directors of NYSE Group or any other affiliate. Moreover, the NYSE's code of business conduct and ethics and culture of confidentiality will ensure the appropriate relationship between regulatory and market activities. The personnel of NYSE Regulation will also be prohibited from owning stock of NYSE Group. This corporate and governance structure will help ensure the independence of NYSE Regulation and its compliance with its regulatory responsibilities under the Exchange Act.

- *Chief Regulatory Officer*. Regulation SRO provides that the board of a securities exchange should appoint a Chief Regulatory Officer to administer the regulatory program of the exchange, and that the Chief Regulatory Officer should report directly to the proposed independent Regulatory Oversight Committee. As set forth in the Proposed Rule Change, after the merger, the Chief Executive Officer of NYSE Regulation will act in the capacity of Chief Regulatory Officer of NYSE Group and its subsidiaries, and report solely to the NYSE Regulation board of directors, which will succeed to the responsibilities of the NYSE's Regulatory Oversight Committee. In addition, the Chief Executive Officer of NYSE Regulation will not be an officer or employee of any unit of NYSE Group other than NYSE Regulation. The NYSE notes that it implemented this "direct line" reporting several years ago, when it was determined that the Chief Regulatory Officer would report directly to the Regulatory Oversight Committee of the Board of Directors of the NYSE. The NYSE respectfully submits that this governance structure has worked well to assure the autonomy of the chief regulatory officer and insulate NYSE Regulation from any competing interests of the NYSE.

- *Use of Proceeds from Regulatory Operations*. As outlined in the purpose section of the Form 19b-4 filing for the Proposed Rule Change, NYSE Regulation will determine,

assess, collect and retain for regulatory purposes regulatory fees and fines. As is currently the case, a large portion of NYSE Regulation's revenues will be derived from fees paid by member organizations as a percentage of their gross revenues. NYSE Regulation does not anticipate any significant changes to these fees. New York Stock Exchange LLC, NYSE Market and NYSEArca will also pay fees to NYSE Regulation in return for the regulatory services that NYSE Regulation provides to them. Moreover, NYSE Regulation will collect regulatory fines from persons who violate its rules and regulations. Regulation SRO provides that a securities exchange must direct monies collected from regulatory fees, fines or penalties exclusively to fund the regulatory operations and other programs of the exchange related to its regulatory responsibilities. As outlined in the Proposed Rule Change, upon completion of the merger, the operating agreement of New York Stock Exchange LLC will prohibit New York Stock Exchange LLC from using any assets of, or any regulatory fees, fines or penalties collected by, NYSE Regulation for commercial purposes or distributing such assets, fees, fines or penalties to NYSE Group or any affiliate other than NYSE Regulation.

- *Treatment of Regulatory Information.* Regulation SRO provides that exchanges must establish policies and procedures to prevent the dissemination of regulatory information to people who are not directly involved in carrying out the exchange's regulatory functions, in order to prevent the use of such information by those not directly involved in the exchange's regulatory function and to safeguard confidential regulatory information. As outlined in the Proposed Rule Change, the NYSE Group Certificate of Incorporation will provide that, to the fullest extent permitted by applicable law, all confidential information pertaining to the self-regulatory function of New York Stock Exchange LLC contained in the books and records of any of the regulated subsidiaries that shall come into the possession of NYSE Group shall not be made available to any persons other than to those officers, directors, employees and agents of NYSE Group who have a reasonable need to know the contents thereof and shall be retained in confidence by NYSE Group and its officers, directors, employees and agents; and not be used for any commercial purposes. We note, however, that this does not prohibit NYSE Market from communicating information pertaining to the self-regulatory functions to NYSE Regulation for the purpose of ensuring compliance with rules and regulations of NYSE Regulation.[26]

[26] In their joint comment letter, the Securities Industry Association and the Bond Market Association state that the proposed delegation agreement among New York Stock Exchange LLC, NYSE Market and NYSE Regulation should clarify that the confidentiality provisions in that agreement should not restrict access to market data, and that all trading data (other than names of counterparties) should be available at cost after some brief period of time. The Securities Industry Association and the Bond Market Association misread these provisions. These provisions only apply to the "confidential" information pertaining to the self-regulatory function of New York Stock Exchange LLC, and, therefore, would not apply (as the Securities Industry Association and the Bond Market Association suggest) to the type of market data that has been for years disseminated to the public.

The NYSE will implement several additional structural and governance changes to ensure its independence. For example, the NYSE Group certificate of incorporation will contain ownership and voting limitations to prevent any stockholder or group of related stockholders from having undue control over NYSE Group (and therefore the SROs owned by NYSE Group). The NYSE Group certificate of incorporation will also contain provisions that will require:

- NYSE Group to give due regard to the preservation of the independence of the self-regulatory function of its SROs and to obligations to investors and the general public;

- NYSE Group not to take any action that would interfere with the effectuation of any decisions by the board of directors of its SROs relating to their regulatory functions (including disciplinary matters) or that would interfere with the ability of its SROs to carry out their respective responsibilities under the Exchange Act;

- NYSE Group, its directors and officers, and those of its employees whose principal place of business and residence is outside of the United States, to submit irrevocably to the jurisdiction of the U.S. federal courts and the SEC for the purposes of any suit, action or proceeding pursuant to the U.S. federal securities laws, and the rules and regulations thereunder, commenced or initiated by the SEC arising out of, or relating to, the activities of its SROs; and

- the directors, officers and employees of NYSE Group, in discharging their responsibilities in such capacity, to cooperate with the SEC and NYSE Group's SROs pursuant to their regulatory authority.