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Interim *Chairman and CEO*

SR-NYSE-2003-34

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November 25, 2003

The Honorable William H. Donaldson
Chairman
U.S. Securities and Exchange Commission
450 5th Street, N.W.
Washington, DC 20549

Dear Bill,

Given some of the comments in the Senate on Thursday, I thought that it would be useful to share my thinking as it relates to our proposal. You may want to consider this as a "comment" for the consideration of the Commission.

As you know, I was brought in to address a governance failure. I took my task to be –make recommendations that would fully address the historic problem and provide a robust platform for moving forward, but stop short of making decisions that would speak to the conversation about market structure unless they could not be avoided as part of my core mandate. (I am not managerially shy and have developed as set of views but have disciplined myself to stick to my mandate...to the frustration of many).

I have had a fair amount of experience with risk management and regulation and feel that the SRO model can quite properly fit within the governance structure of the NYSE. There are a number of design elements that make this so. First, a pure "outside""independent" Board is a core requirement (And, I would emphasize pure because as you know Boards rarely vote but reach conclusions and make judgments based on conversation and a mixed industry/outside Board is simply different than a fully outside Board in terms of that conversation...). Second, a special Oversight Committee of the Board with an obligation to assess the regulatory performance, to deal with regulatory issues and their resolution, approve an annual regulatory plan, approve both staffing and the regulatory budget – all of this surrounded by the need to publish the Committee's charter as approved by the Board and publish an Annual Report (in the proxy) of the Committee's activities probably insures competent oversight. Third, it is also true that in the case of the NYSE, business issues are somewhat distant from the management. We host the environment (the Exchange) where members ply their trade and make their money but do not directly participate in their results. It is not that we are indifferent to the overall results...but still, there is a distance that helps the architecture. Fourth, there is no doubt but that the success of the NYSE requires a tough but fair regulatory regime that is publicly visible.

The final architectural element is that the SRO falls under "tight" SEC oversight.

Obviously, my mandate did not include any consideration of the global architectural issues. It seems to me that market regulation simply parallels the general issue of private sector regulation. What we are seeking is a robust and, effective array of capabilities and responsibilities with some targeting, self appraising and correcting features that will insure that our markets and the private sector will maintain their dynamic but within a "proper" pathway.

We start with Board and governance responsibilities as per a long history which very importantly holds Boards accountable, ending most recently with Sarbanes-Oxley. I would add (and we did for the NYSE) a clear obligation that the Chair is responsible for the Board's overall performance.

We then ask that the audit function or a "self regulating" function be under the oversight of a Committee comprised solely of competent outside independent Directors. We further ask that the Committee assess the performance of the auditors (or the self-regulatory function) and certify that proper controls are in place (proper regulatory competence) and approve the audit plans (regulatory plans). The Committee hires the auditors (the senior regulatory officer) and is empowered to employ outside competence...lawyers, accountants, etc. (The charter of a Regulatory Oversight Committee should also provide for this.) The Committee reviews audit findings (regulatory findings) and monitors management's response. The Committee insures that a proper channel to pick-up and respond to outside criticisms (whistle blower) is in place and functioning. (The NYSE will too.) The Committee publishes its charter and reports on its activities annually.

The SEC sits on top of all of this, with full powers.

With regard to the financial industry, which has special importance, you could imagine an alternative array...one like the FSA in England, that would combine banking, security dealers, markets and listed company regulation (The industry is certainly consolidating along these lines.) in a centralized function. There is, however, no reason to imagine that a single consolidated regulator would be any more effective than a dispersed model unless you believe that the model is compromised by its proximity to the entity being regulated. Even then, there is some reason to imagine that it would be equally dependent on an "FSA's" interaction with internal control functions (banking supervision engages with internal audit groups and internal risk management functions) and the only true difference would be the consolidation of regulatory functions across the industry. The fact is that a regulatory function has to be tightly coupled with the operations being regulated (I have seen it in banking, in the military procurement process, when I was on the Board of United Technologies, in the medical business when I chaired the Audit Committee of Memorial Sloan Kettering for twenty years and even in interaction with the FDA when I sat on the Scientific Committee of Pharmacia) and regulatory supervision as practiced by the SEC, the FSA, the Department *of* Defense, the Department of Health and Human Services or the FDA comes down to close supervision and intrusive review of internal capabilities and findings.

Keeping alert and responsive is a managerial issue and cannot be solved by . architecture. This is a central problem in an FSA model and also in a dispersed set up as we have today.

I hope this is of some use.

Best regards,