

addition to the revisions to the NYSE Constitution approved in this Order. Those other changes include, among other things, commitments to increase the transparency of the Board and Board Committees by requiring the disclosure of Committee charters and bases for certain Board and Committee action; to provide a means by which members and investors may communicate with the NYSE's non-management directors; and to provide annual reports regarding certain activities of the Board and several key committees, including an annual report detailing the charitable activities of or on behalf of the Exchange.

III. Summary of Comments on NYSE Proposal

The Commission received a total of 18 comment letters on the NYSE proposal.⁴⁶ A number of commenters broadly supported the NYSE's proposed governance changes, at least to the extent that the changes are considered a positive initial step toward reform.⁴⁷ Many of the commenters, however, stated that the proposals did not go far enough. For example, they expressed concerns about the adequacy and effectiveness of the NYSE's revisions to its governance, particularly with respect to the composition of the Board of Directors, the establishment of the Board of Executives, and the structure of the regulatory function.⁴⁸ Several commenters also urged the Commission not to approve the proposal until the NYSE had made further changes to it,

arguing that the proposal did not go far enough to restore investor confidence.⁴⁹ The commenters generally addressed issues falling into one or more of the categories discussed below.

A. The Board of Directors

A number of commenters criticized the proposed composition of the Board of Directors for failing to include investor representatives on the Board.⁵⁰ Two commenters referred to investors as being the "ultimate constituency" of the Exchange and consequently there should be several investor representatives on the Board.⁵¹ Another commenter advocated that the Board should have "significant representation" from the public institutional investor community, and yet another commenter stated that approximately one-third of Board seats should be reserved for investor representatives.⁵² In contrast, one commenter criticized the proposed Board composition for excluding industry representatives from serving as directors.⁵³ This commenter argued that industry professionals bring valuable experience and insight to the Board in addressing regulatory and other issues, particularly in hectic times.

Four commenters questioned the independence of the directors.⁵⁴ In particular, these commenters suggested that director independence is compromised by the fact that directors are elected by the Exchange members or by their ties to corporate America. One commenter proposed having the Commission and the North American Securities Administrators Association each annually appoint individuals having a background in securities regulation to one seat on the Board in order to ensure some independent and qualified representation.⁵⁵

Several commenters questioned the ability of the reconstituted Board to operate effectively.⁵⁶ One of these commenters raised concerns regarding the directors' availability (noting in particular one candidate who serves on eight Boards for listed companies in addition to other long term commitments, and two other candidates who live in the United Kingdom). This

commenter expressed doubts that the Board would be able to handle the responsibilities of regular Board meetings, meetings with the Board of Executives, and overseeing and serving on the various key standing committees.⁵⁷ Another commenter questioned the ability of a small body of public directors, meeting only four times a year, to function without help from securities professionals.⁵⁸ One commenter also expressed concern about the proposed directors' lack of securities industry experience, as well as their ties to corporate America and/or the financial services industry.⁵⁹

B. Board of Executives

Several commenters disputed the efficacy of having the proposed Board of Executives. One commenter argued that the creation of a Board of Executives is an inadequate substitute for direct industry participation in exchange governance.⁶⁰ Two commenters characterized the existence of the Board of Executives, in addition to the Board of Directors, as an unnecessarily complex structure, having no advantages over the traditional Board structure with independent key committees, and as setting a poor example for listed companies.⁶¹ One of the commenters also expressed a concern that the dual Board structure would obfuscate rather than enhance accountability.⁶²

Another commenter criticized the composition of the Board of Executives for not having adequate "buy-side" representation, arguing that the Board of Executives as proposed would be composed primarily of "sell-side" representation.⁶³ This commenter advocated increasing the number of members representing individual and institutional investors.

C. Regulatory Function

A majority of commenters called for greater independence of the regulatory function from the business operation of the NYSE.⁶⁴ Most of these commenters advocated a complete separation of the regulatory function from the Exchange.⁶⁵ Several commenters

⁴⁶ Exhibit A to this Order contains a list of comment letters received by the Commission on the NYSE proposal as of December 12, 2003, including the citations to the comment letters referenced in this Order. The public file for the proposed rule change includes a letter to Chairman Donaldson from NYSE Interim Chairman & CEO John S. Reed regarding the NYSE proposal. The Reed Letter stated that the SRO model can properly fit within the governance structure of the Exchange and pointed to five design elements that support this view. For example, the Reed Letter pointed to a pure "outside" "independent" Board as a core requirement, and a special Oversight Committee of the Board with its specific functions and a charter that will be made public, as design elements. The Reed Letter also pointed out that the fact that the Exchange hosts the trading environment for members but does not directly participate in members' results helps create a distance between business issues and management. Another design element noted in the Reed Letter is that the success of the Exchange requires a tough but fair regulatory regime that is publicly visible. The Reed Letter noted the existence of "tight" SEC oversight as the final design element. The Second Reed Letter, *infra* Section IV, is also contained in the public file for the proposed rule change.

⁴⁷ See Saul Letter, ICI Letter, First CII Letter, and SIA Letter.

⁴⁸ See Saul Letter, Peake Letter, CalPERS Letter, CALSTRS Letter, ICI Letter, First CII Letter, PIABA Letter, SIA Letter, State Treasurers' Letter, Knotter Letter, and Ohio Retirement Systems Letter.

⁴⁹ See CalPERS Letter, CALSTRS Letter, and ICI Letter.

⁵⁰ See CalPERS Letter, CALSTRS Letter, ICI Letter, PIABA Letter, State Treasurers' Letter, and Ohio Retirement Systems Letter.

⁵¹ See ICI Letter and State Treasurers' Letter.

⁵² See CALSTRS Letter and CalPERS Letter, respectively.

⁵³ See Saul Letter.

⁵⁴ See Anderson Letter, CALSTRS Letter, PIABA Letter, Knotter Letter and Second CII Letter.

⁵⁵ See PIABA Letter.

⁵⁶ See Saul Letter, Peake Letter, and PIABA Letter.

⁵⁷ See Peake Letter.

⁵⁸ See Saul Letter.

⁵⁹ See PIABA Letter.

⁶⁰ See Saul Letter.

⁶¹ See CalPERS Letter and CALSTRS Letter.

⁶² See CALSTRS Letter.

⁶³ See ICI Letter.

⁶⁴ See Peake Letter, CalPERS Letter, Merrill Letter, CALSTRS Letter, First CII Letter, SIA Letter, State Treasurers' Letter, Second CII Letter, Ohio Retirement Systems Letter, and Sonoma Letter.

⁶⁵ See Peake Letter, CalPERS Letter, Merrill Letter, First CII Letter, SIA Letter, Second CII Letter,