

suggested that the Commission consider alternative regulatory models, including merging the Exchange's regulatory function with that of the NASDR, adopting a "hybrid SRO," or having the Commission take a more direct regulatory role.⁶⁶

Several commenters questioned the effectiveness of the regulatory oversight of a Board whose members are directly elected by the persons they are regulating.⁶⁷ One commenter proposed that a nomination model similar to that in place for the Public Company Accounting Oversight Board be adopted for nominating the directors charged with overseeing the regulatory arm of the Exchange, with the SEC having sole responsibility of appointing the directors of the oversight bodies.⁶⁸

In contrast, another commenter argued that member participation in regulation was necessary, and that a Board of Directors consisting solely of public directors would find itself "severely handicapped" in dealing with regulatory issues, despite the presence of an advisory Board of Executives.⁶⁹ This commenter also expressed concern that the proposal represents a major change in regulation and that it was proposed without a full discussion of the consequences. This commenter argued that one of the possible consequences of excluding member representatives from the Board is that Exchange members might turn away from the Exchange and the auction system, resulting in internalized order flow and a fragmented market. This commenter also stated that member participation makes regulation more "palatable" and generates awareness of regulatory issues.

D. Committee Structure

One commenter expressed concern that, with respect to the Market Structure Committee, a mixed committee of members of the Board of Directors and the Board of Executives, the proposal did not explicitly require a majority of directors to be members of this committee.⁷⁰ This commenter criticized this omission, stating that the most crucial part of the regulatory structure is market structure, particularly in light of recent controversies. This commenter also criticized the fact that the Nominating &

Governance Committee is composed solely of existing directors, and has no outside members, and argued that this creates a self-perpetuating Board.

E. Chairman and CEO

Two commenters expressed concern that allowing the CEO and Chairman to be the same person would result in a concentration of too much power, particularly in light of the fact that, under this proposal, the Chairman also would act as the sole liaison between the Board of Directors and the Board of Executives.⁷¹ Another commenter also urged separation of the Chairman and CEO functions to enhance the independence of the Board of Directors.⁷²

F. Transparency

Several commenters proposed that the Exchange take additional steps to improve its transparency,⁷³ advocating that the Exchange should set the "gold standard" for disclosure.⁷⁴ One commenter stated that the Exchange should be under the same disclosure requirements as listed companies.⁷⁵ In addition, this commenter asserted that the Exchange should disclose all ties between Board members, that the Exchange should be banned from making any charitable or political contributions, and that the Exchange should post all documents relating to Board and committee reports and compensation disclosures on its Web site.⁷⁶ Another commenter proposed that all key Exchange committees be required to publish annual reports on how they functioned and executed their duties.⁷⁷

In addition, a few commenters urged that final details on the compensation package of the Exchange's former Chairman be made public.⁷⁸

IV. NYSE's Response to the Comment Letters

The Exchange, through its Interim Chairman and CEO, submitted a letter dated December 11, 2003, which responds to issues raised by the commenters.⁷⁹ The Exchange noted that the proposed rule change was "intended to solve an immediate board-level governance problem faced by the

Exchange" and was "not intended to address all structural issues that the Exchange, and indeed our industry, now face."

The Exchange took issue with the view of several commenters that the Board should include one or more individuals to represent the interest of the public investor. The Exchange stated that "the single most important feature of the proposed rule change is that, with the exception of the CEO, the [Board] is completely independent." In that regard, the Exchange noted that "[a]s the Exchange's fiduciaries, our directors will not have the agenda of a customer, an owner or user, and will not represent any single constituent group." Therefore, the Exchange concluded that "it would be inappropriate to seek to specifically include [Board] members that are representative of the buy-side or of any particular constituent group."

The Exchange acknowledged that individual investors are the Exchange's "ultimate constituency." However, the Exchange stated that "individual investors trading on the Exchange through broker-dealers in small volumes have interests that conflict with other individual investors who participate in the market through public or private funds trading in larger volumes." Thus, the Exchange stated that the "hard-won lesson is that the only way to sort out these issues without bias or conflicts is through an independent board whose primary goal is to 'do the right thing' for the individual investor as such."

Finally, in response to commenters who believed that there should be an individual investor representative on the Board of Executives, the Exchange noted that it intends to amend its Constitution to provide for an individual investor representative on the Board of Executives.

In response to comments regarding regulation and the merits of separating the regulatory and market functions of the Exchange, the NYSE reiterated its position as set forth in the proposed rule change that the filing "does not ask the Commission to approve either the continuation of self-regulation in the United States or at the Exchange." The Exchange noted that "[i]f the Commission decides that broker-dealers should continue to regulate themselves through national securities exchanges, [the] Exchange's new governance architecture provides the best model for resolving and managing conflicts of interest inherent in self-regulation while maintaining the marketplace proximity requisite for optimizing regulatory intervention in delicate market mechanisms." The Exchange added that it expects to implement its model

Ohio Retirement Systems Letter, and Sonoma Letter.

⁶⁶ See Peake Letter, Second CII Letter, SIA Letter, and Sonoma Letter.

⁶⁷ See Anderson Letter, CALSTRS Letter, PIABA Letter, and Knott Letter.

⁶⁸ See Second CII Letter.

⁶⁹ See Saul Letter.

⁷⁰ See Peake Letter.

⁷¹ See CalPERS Letter and CALSTRS Letter.

⁷² See Ohio Retirement Systems Letter.

⁷³ See CALSTRS, First CII Letter, State Treasurers' Letter, and Second CII Letter.

⁷⁴ See CALSTRS and Second CII Letter.

⁷⁵ See First CII Letter.

⁷⁶ See also Second CII Letter.

⁷⁷ See CALSTRS Letter.

⁷⁸ See CALSTRS Letter and State Treasurers' Letter.

⁷⁹ See Second Reed Letter.