

through an independent Board and through a division of regulatory and marketplace functions within the Exchange, including by having a Chief Regulatory Officer reporting directly to the Board of Directors.

In conclusion, the Exchange noted that its proposal seeks to address a "very immediate board-level governance problem" and urged that "the Commission approve the proposed rule change as soon as possible so that the Exchange can continue to function effectively as a marketplace while revitalizing its regulatory function and addressing other important issues from a much improved governance platform."

V. Discussion

The Commission has considered the Exchange's proposed rule change and finds that, in the context in which they were submitted, the proposed amendments to the NYSE Constitution are consistent with the Act and the rules and regulations promulgated thereunder that are applicable to a national securities exchange and, in particular, with the requirements of section 6(b) of the Act.⁸⁰ Specifically, the Commission finds that, in this context, the amended and restated Constitution is consistent with section 6(b)(1) of the Act⁸¹ which requires that the exchange be "so organized and [have] the capacity to carry out the purposes of [the Act]" and to "enforce compliance by its members and persons associated with its members with the provisions of [the Act]." The Commission also finds that, in this context, the amended and restated Constitution is consistent with section 6(b)(3) of the Act,⁸² which requires that the rules of a national securities exchange assure the fair representation of its members in the selection of its directors and administration of its affairs, and provide that one or more directors shall be representative of issuers and investors and not be associated with a member of the exchange, broker, or dealer. In addition, the Commission finds that, in this context, the amended and restated Constitution is consistent with section 6(b)(5) of the Act⁸³ in that it is designed, among other things, to facilitate transactions in securities; to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; to remove impediments to and perfect the

mechanism of a free and open market and a national market system; and in general, to protect investors and the public interest, and does not permit unfair discrimination among issuers. Further, the Commission finds that, in this context, the amended and restated Constitution is consistent with section 6(b)(7) of the Act,⁸⁴ which, among other things, requires that the rules of a national securities exchange provide a fair procedure for the disciplining of members and persons associated with members.

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.⁸⁵

The Commission discusses below significant aspects of the amendments to the NYSE Constitution.

A. Board of Directors

The amended Constitution provides for a smaller board, composed of independent directors (other than the CEO). Board members (excluding the CEO) must be independent from the management of the Exchange, from the members of the Exchange, and from the issuers listed on the Exchange. In addition, the Exchange must make an affirmative determination of a director's independence. The NYSE also commits to adopting specific standards requiring that the independence determination be comparable to the standards required of listed issuers. Generally, the Board will supervise the regulatory function; monitor the Exchange's performance; approve the Exchange's strategy; hire, fire and determine the compensation of senior management; create a succession plan; and ensure appropriate behavior

by Exchange employees, officers and directors.

The Commission believes that the proposal to completely replace the previously large, mixed-composition NYSE Board with a smaller board composed of independent directors (other than the CEO) should increase the likelihood that the directors will be free of any relationship that might impair, or appear to impair, the directors' ability to make judgments in the best interest of the Exchange and investors. The changes to the Constitution explicitly prohibit a director from being a member or lessor member, an officer or employee of the Exchange (except for the CEO), a person employed by or affiliated with a member organization or with a broker-dealer that has substantial direct contact with securities customers, or an executive officer of a listed issuer. Not only must the Board make an affirmative determination that the director (other than the CEO) has no material relationship with the Exchange, it also must assess the director's eligibility according to specific standards relating to independence that are comparable to the standards the NYSE now requires of its listed companies.⁸⁶ Indeed, the Commission notes that the NYSE proposal goes one step further than the new requirements for NYSE listed companies because the NYSE will have a board composed of independent directors (except for the CEO), whereas NYSE listed companies must have only a majority of independent directors on their boards.⁸⁷ Several commenters raised doubts about the independence of the NYSE directors because of the ties that directors may have to corporate American and/or the financial industry. Also, a few commenters advocated a greater role by the Commission in appointing NYSE directors in order to further assure the directors' independence. The Commission believes that this "independence" standard for the NYSE Board should benefit the Exchange by assuring that key decisions are made by persons free from material relationships

⁸⁶ See NYSE Constitution Article IV, Section 2, which states that the Exchange "shall adopt specific standards relating to such determination, comparable to the standards required of issuers listed on the Exchange, by effecting a rule change within the meaning of section 19(b)(1) of the Act." 15 U.S.C. 78s(b)(1). See also NYSE/Nasdaq Corporate Governance Listing Standards Approval Order. The Commission expects the NYSE to file shortly after issuance of this Order a proposed rule change pursuant to section 19(b) of the Act that contains independence standards for NYSE directors comparable to those recently adopted for its listed issuers.

⁸⁷ The Commission notes that the NYSE's CEO would be the only director that would not meet the definition of "independence."

⁸⁰ In approving the proposed rule change, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c (f).

⁸¹ 15 U.S.C. 78f(b)(1).

⁸² 15 U.S.C. 78f(b)(3).

⁸³ 15 U.S.C. 78f(b)(5).

⁸⁴ 15 U.S.C. 78f(b)(7).

⁸⁵ 15 U.S.C. 78f(b)(3).