SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53382; File No. SR-NYSE-2005-77)

February 27, 2006

Self-Regulatory Organizations; New York Stock Exchange, Inc.; Order Granting Approval of Proposed Rule Change and Amendment Nos. 1, 3, and 5 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 6 and 8 Relating to the NYSE's Business Combination with Archipelago Holdings, Inc.

I. Introduction

On November 3, 2005, the New York Stock Exchange, Inc. ("NYSE") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934, as amended ("Act"),[1] and Rule 19b-4 thereunder,[2] a proposed rule change relating to the NYSE's business combination with Archipelago Holdings, Inc. ("Archipelago"). On December 1, 2005, the NYSE filed Amendment No. 1 to the proposed rule change. The NYSE filed Amendment No. 2 to the proposed rule change on December 12, 2005, and withdrew Amendment No. 2 on December 12, 2005. On December 12, 2005, the NYSE filed Amendment No. 3.[3] The NYSE filed Amendment No. 4 to the proposed rule change on December 21, 2005, and withdrew Amendment No. 4 on December 21, 2005. On December 21, 2005, the NYSE filed Amendment No. 5.[4] The proposed rule change, as amended, was published for comment in the Federal Register on January 12, 2006.[5] The Commission has received

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1 15 U.S.C. 78s(b)(l).

2 17 CFR 240.19b-4.

3 See Form 19b-4 dated December 12, 2005 ("Amendment No. 3"). Amendment No. 3 replaced Amendment No. 1 in its entirety.

4 See Partial Amendment dated December 21, 2005 ("Amendment No. 5").

5 See Securities Exchange Act Release No. 53073 (January 6, 2006), 71 FR 2080 ("Notice").

seventeen comments on the proposal.[6] The NYSE filed a response to comments on February 8,

[6] See letter from Michael Kanovitz, Attorney, Loevy & Loevy, to Nancy Morris, Secretary, Commission, dated February 2, 2006, with attachments, including a statement from Lewis J. Borsellino to the Commission ("Borsellino Letter"); letter from Dennis A. Johnson, Senior Portfolio Manager, Corporate Governance, California Public Employees' Retirement System, to Jonathan Katz, Secretary, Commission, dated February 2, 2006 ("CalPERS Letter"); letter from Warren Meyers, President, Independent Broker Action Committee, to Jonathan G. Katz, Secretary, Commission, dated December 16, 2005 ("IBAC December Letter"); letter from Warren P. Meyers, President, Independent Broker Action Committee, Inc., to Nancy M. Morris, Secretary, Commission, dated February 2, 2006 ("IBAC February Letter"); letter from Ari Burstein, Associate Counsel, Investment Company Institute, to Nancy M. Morris, Secretary, Commission, dated February 2, 2006 ("ICI Letter"); letter from James L. Kopecky, James L. Kopecky, P.C., to Christopher Cox, Chairman, Commission, dated January 16, 2006, with attachments ("Kopecky Letter"); letter from Fane Lozman to Christopher Cox, Chairman, Commission, dated February 22, 2006, with attachments ("Lozman Letter"); letter from Barbara Z. Sweeney, Senior Vice President and Corporate Secretary, NASD, to Nancy M. Morris, Secretary, Commission, dated February 16, 2006 ("NASD Letter"); letter from Edward S. Knight, Executive Vice President and General Counsel, The Nasdaq Stock Market, to Nancy M. Morris, Secretary, Commission, dated January 25, 2006 ("Nasdaq Extension Letter"); letter from Edward S. Knight, The Nasdaq Stock Market, to Nancy M. Morris, Secretary, Commission, dated February 2, 2006 ("Nasdaq February Letter"); letter from Randall Edwards, President, National Association of State Treasurers, to Nancy M. Morris, Secretary, Commission, dated January 31, 2006 ("NAST Letter"); letter from Philip J. Nathanson, Philip J. Nathanson & Associates, to Christopher Cox, Chairman, Commission, dated February 2, 2006, with attachments ("Nathanson Letter"); letter from "The Undersigned NYSE Investors" to Jonathan G. Katz, Secretary, Commission, dated December 23, 2005, with attachments ("OTR Investors Letter"); letter from Andrew Rothlein to Nancy Morris, Secretary, Commission, dated February 12, 2006 ("OTR Investors Letter II"); letter from George R. Kramer, Deputy General Counsel, Securities Industry Association, to Nancy M. Morris, Secretary, Commission, dated January 18, 2006 ("SIA Extension Letter"); letter from Marc E. Lackritz, President, Securities Industry Association and Micah S. Green, President and CEO, The Bond Market Association, to Nancy M. Morris, Secretary, Commission, dated February 2, 2006, with attachments ("SIA/TBMA Letter"); and letter from Marjorie E. Gross, Senior Vice President & Regulatory Counsel, The Bond Market Association, to Nancy M. Morris, Secretary, Commission, dated January 23, 2006 ("TBMA Letter").

2006.[7]

On January 20, 2006, the NYSE filed Amendment No. 6 to the proposed rule change.[8] On February 21, 2006, the NYSE filed Amendment No. 7 to the proposed rule change, and withdrew Amendment No. 7 on February 22, 2006. On February 23, 2006, the NYSE filed Amendment No. 8 to the proposed rule change.[9] This order approves the proposed rule change, as amended, grants accelerated approval to Amendment Nos. 6 and 8 to the proposed rule change, and solicits comments from interested persons on Amendment Nos. 6 and 8.

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.[10] In particular, the Commission finds that the proposed rule change, as amended, is consistent with Section 6(b) of the Act,[11] which, among other things, requires a national securities exchange to be so organized and have the capacity to be able 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 rules and regulations thereunder,

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7 See letter from Mary Yeager, Assistant Secretary, NYSE, to Nancy M. Morris, Secretary, Commission, dated February 7, 2006 ("NYSE Response to Comments"). See also letter from Kevin J.P. O'Hara, Chief Administrative Officer, General Counsel and Secretary, to Nancy M. Morris, Secretary, Commission, dated February 24, 2006.

8 See Partial Amendment dated January 20, 2006 ("Amendment No. 6").

9 See Partial Amendment dated February 23, 2006 ("Amendment No. 8"). The text of Amendment Nos. 6 and 8, and Exhibits 5A through 5K of Amendment No. 8, which set forth the text of the NYSE rules and the governing documents, as proposed to be amended, is available on the Commission's Web site (http://www.sec.gov/rules/sro.shtml), at the Commission's Public Reference Room, at the NYSE, and on the NYSE's Web site (http://www.nyse.com).

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

11 15 U.S.C. 78f(b).

and the rules of the exchange, and 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. Section 6(b) of the Act[12] also requires that the rules of the exchange provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities, be designed 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.

A. Accelerated Approval of Amendment Nos. 6 and 8

The Commission also finds good cause for approving Amendment Nos. 6 and 8 to the proposed rule change prior to the thirtieth day after publishing notice of Amendment Nos. 6 and 8 in the Federal Register pursuant to Section 19(b)(2) of the Act.[13]

In Amendment No. 6, the NYSE made changes to the proposed Amended and Restated Bylaws of NYSE Regulation, Inc. ("NYSE Regulation") ("NYSE Regulation Bylaws") to (1) reduce the number of NYSE Group, Inc. ("NYSE Group") directors on the NYSE Regulation board from a majority to a minority and increase the number of directors not affiliated with NYSE Group to a majority, (2) reduce the number of members of the NYSE Regulation nominating and governance committee that are also directors of NYSE Group from a majority to a minority, and (3) specify that NYSE Regulation will have a compensation committee

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12 Id.

13 15 U.S.C. 78s(b)(2). Pursuant to Section 19(b)(2) of the Act, the Commission may not approve any proposed rule change, or amendment thereto, prior to the thirtieth day after the date of publication of the notice thereof, unless the Commission finds good cause for so doing.

responsible for setting the compensation for NYSE Regulation employees and that such committee will have a majority of directors that are not also NYSE Group directors. In addition, in Amendment No. 6, the NYSE (1) acknowledged that NYSE Group, New York Stock Exchange LLC, and NYSE Market, Inc. ("NYSE Market") are responsible for referring possible rule violations to NYSE Regulation, (2) specified that there will be an explicit agreement among various of the NYSE Group entities to provide adequate funding for NYSE Regulation, and (3) represented that the NYSE has undertaken to work with NASD and securities firm representatives to eliminate inconsistent rules and duplicative examinations.

The Commission believes that these changes will provide additional safeguards to help ensure the independence of NYSE Regulation from the market operations and commercial interests of the exchange. Furthermore, the changes proposed in Amendment No. 6 will help ensure adequate funding of NYSE Regulation, through an explicit agreement with NYSE Group and its subsidiaries. In addition, the ability of NYSE Regulation to effectively carry out its regulatory responsibilities will be enhanced by the explicit acknowledgement that NYSE Group, New York Stock Exchange LLC, and NYSE Market each will be responsible for referring possible rule violations to NYSE Regulation, consistent with the self-regulatory obligations of New York Stock Exchange LLC and NYSE Market. The Commission therefore believes that these provisions of Amendment No. 6, which are designed to further the ability of the New York Stock Exchange LLC and its subsidiaries to comply with their statutory obligations, are consistent with the Act, and therefore finds good cause exists to accelerate approval of these proposed rule changes in Amendment No. 6, pursuant to Section 19(b)(2) of the Act.[14]

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[14] 15 U.S.C. 78s(b)(2).

The NYSE also represented in Amendment No. 6 that it will work with NASD and securities firm representatives to eliminate inconsistent rules and duplicative examinations, and will use its best efforts to submit to the Commission, within one year, proposed rule changes reconciling inconsistent rules and a report setting forth those rules that have not been reconciled.

Several commenters expressed concern about regulatory burdens in connection with the proposed new structure.[15] In particular, although Nasdaq recognizes that the NYSE has undertaken to work with NASD to eliminate inconsistent rules and duplicative examinations, it believes the proposal does not go far enough.[16] Nasdaq believes that the structure proposed by the NYSE is inherently problematic, and that the Commission should insist that the NYSE in this filing rationalize inconsistent and duplicative regulation.[17] In addition, while the ICI strongly supports the NYSE's initiative to work with NASD, it urges the Commission to set forth a specific time frame during which recommendations by the NYSE and NASD will be developed.[18] The SIA and TBMA also welcome the NYSE's undertaking, but believe that it falls far short of addressing the problem.[19] While they do not wish to delay approval of the NYSE's proposal, they urge the Commission to ask the NYSE to formally commit to work with NASD with a goal of developing, within a set time frame (such as sixty to ninety days) of

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15 See ICI Letter, Nasdaq February Letter, and SIA/TBMA Letter, supra note 6. See also Nasdaq Extension Letter, supra note 6.

16 Nasdaq February Letter, supra note 6, at 7.

17 Id. at 7-8.

18 See ICI Letter, supra note 6, at 2-3.

19 See SIA/TBMA Letter, supra note 6, at 5.

approval, recommendations and an implementation timetable for appropriate consolidation of the broker-dealer regulatory functions of the two self-regulatory organizations ("SROs").[20]

The NASD believes that the NYSE's proposal will exacerbate the extent of duplicative regulation, and that even if the NYSE were to follow through on its undertaking to identify and reconcile inconsistencies in its and NASD's member rules, the harmonization of duplicative rules amounts to a treatment of some, but not all, of the symptoms of the larger problem.[21] In addition, NASD believes that harmonization fails to resolve the conflicts of interest that arise when an SRO operates a for-profit exchange and regulates that exchange's participants.[22] NASD urges the Commission to adopt a hybrid model of self-regulation to resolve these conflicts and eliminate duplication.[23] The SIA and TBMA also believe that combining the duplicative functions of NASD and NYSE broker-dealer regulation into one entity could address business conflict and regulatory duplication concerns,[24] and Nasdaq states that it believes a consolidated "hybrid" SRO is in the best interests of investor protection.[25]

The Commission recognizes that the existence of multiple SROs can result in duplicative and conflicting SRO rules, rule interpretations, and inspection regimes, and result in redundant

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20 Id. at 23.

21 See NASD Letter, supra note 6, at 2-4. For instance, NASD believes that it will not eliminate all duplicative costs of having two organizations, rather than one, write, administer, and enforce the rules.

22 Id. at 1-2, 4.

23 Id. NASD's proposed hybrid model would unify all regulation of broker-dealer interaction with the public under a single SRO. Regulation of exchange operations – promulgation and enforcement of trading rules, market surveillance and listing standards – would be left to the separate trading market SROs. Id. at 2.

24 SIA/TBMA Letter, supra note 6, at 3.

25 Nasdaq February Letter, supra note 6, at 7.

SRO regulatory staff and infrastructure across SROs.[26] Congress and the Commission have taken steps to reduce regulatory duplication.[27] The question of what further steps should be taken, if any, with respect to this issue is part of a larger Commission review of the self-regulatory structure of our markets.[28] The NYSE cannot on its own eliminate inconsistent rules among SROs and duplicative examinations, and the Commission therefore believes eliminating such inconsistencies and duplication is beyond the scope of this proposed rule change. The Commission believes that the NYSE's representation to the Commission that it will work with NASD and securities firm representatives to eliminate inconsistent rules and duplicative examinations is encouraging. In furtherance of its commitment to work with other industry participants, the NYSE also has represented that it will use its best efforts, in cooperation with NASD, to submit to the Commission within one year proposed rule changes reconciling inconsistent rules and a report setting forth those rules that have not been reconciled.[29] The Commission believes that this undertaking by the NYSE should help advance the effort to make compliance with SRO rules and the examination process more efficient and is consistent with the Act. The Commission also finds good cause to accelerate approval of this undertaking pursuant to Section 19(b)(2) of the Act.[30] The Commission also believes that the issue of whether

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26 See Securities Exchange Act Release No. 50700 (November 18, 2004), 69 FR 71256 (December 8, 2004) ("Concept Release Concerning Self-Regulation"). The Concept Release Concerning Self-Regulation contains a discussion of "Inefficiencies of Multiple SROs."

27 See, e.g., Concept Release Concerning Self-Regulation and Section 17(d) of the Act and Rules 17d-1 and 17d-2 thereunder, 15 U.S.C. 78q and 17 CFR 240.17d-1 and 240.17d-2.

28 See Concept Release Concerning Self-Regulation, supra note 26.

29 See Amendment No. 6, supra note 8.

30 15 U.S.C. 78s(b)(2).

changes should be made with respect to the overall structure of our self-regulatory system is outside the scope of this proposed rule change and is best addressed in the context of the larger Commission review of the self-regulatory structure of our markets.[31]

In Amendment No. 8 the NYSE stated that the proposed rule change, as amended, would not be operative until the date of the closing of the Merger (as defined below). In addition, the NYSE made certain clarifying, technical, non-material, and non-substantive changes to the governing documents of the various NYSE Group entities and the proposed rules of New York Stock Exchange LLC. These changes are clarifying, technical, non-material, or non-substantive in nature, and raise no new or novel issues.

The NYSE also proposes in Amendment No. 8 to change the composition of the New York Stock Exchange LLC board to provide that a majority of the board will be directors of the NYSE Group (other than the CEO). The NYSE originally proposed that all of the NYSE Group directors (other than the CEO) would be on the New York Stock Exchange LLC board. In addition, although the NYSE Group board will have the ability to remove some of the directors on the New York Stock Exchange LLC board, with or without cause, the NYSE proposes in Amendment No. 8 to limit NYSE Group to removing directors on the New York Stock Exchange LLC board that are selected by the members only for cause. Further, the NYSE proposes to eliminate the ability of New York Stock Exchange LLC to remove without cause the directors on the NYSE Market board selected by members and Non-Affiliated Regulation Directors (as

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31 See Concept Release Concerning Self-Regulation, supra note 26.

defined below)[32] on the NYSE Regulation board. These changes will help to strengthen the independence of the exchange's regulatory functions from its commercial interests.

Given the practical necessities of providing time to allow members to participate in the process for the selection of directors following the closing of the Merger, the NYSE in Amendment No. 8 proposes transitional boards of directors for New York Stock Exchange LLC, NYSE Market, and NYSE Regulation until no later than the first annual meetings of New York Stock Exchange LLC, NYSE Market, and NYSE Regulation, which are expected to occur in June 2006.[33]

The Commission believes that the changes proposed in Amendment No. 8 are consistent with the Act and therefore finds good cause to accelerate approval of Amendment No. 8 to the proposed rule change, pursuant to Section 19(b)(2) of the Act.[34]

B. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 6 and 8, including whether Amendment Nos. 6 and 8 are consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NYSE-2005-77 on the subject line.

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32 See infra note 86 and accompanying text.

33 To facilitate the interim board structure, Amendment No. 8 also eliminates the set number of directors for the initial boards of NYSE Market and NYSE Regulation. See Amendment No. 8, supra note 9.

34 15 U.S.C. 78s(b)(2).

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NYSE-2005-77. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the NYSE. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to Amendment Nos. 6 and 8 of File Number SR-NYSE-2005-77 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

The Commission received several requests to extend the comment period for this proposed rule change, citing the length and complexity of the proposed rule change and the critical policy issues raised by the proposed rule change.[35] The proposed rule change was

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[35] See ICI Letter, Nasdaq Extension Letter, Nasdaq February Letter, SIA Extension Letter, and TBMA Letter, supra note 6. One commenter also requested that the

publicly available when originally filed on November 3, 2005, and Amendment Nos. 1, 3, and 5 were publicly available when filed by the NYSE on December 1, 12, and 21, 2005, respectively.[36] In addition, during this time period, the proposed rule change, as amended, was posted on the NYSE Web site.[37] On January 12, 2005, the proposed rule change, as amended by Amendment Nos. 1, 2, 3, 4, and 5, was published in the Federal Register, for a three week comment period. The Commission believes that the public has had sufficient time to review the substance of the NYSE's proposed rule change and provide the Commission with comments.

II. Discussion

The NYSE and Archipelago entered into an agreement ("Merger Agreement") to effect a merger ("Merger"). Following the Merger, the businesses of the NYSE and Archipelago will be held under a single, publicly traded holding company, NYSE Group. The NYSE's current businesses and assets will be held in three separate entities affiliated with NYSE Group – New York Stock Exchange LLC, NYSE Market, and NYSE Regulation. NYSE Market and NYSE Regulation will carry out their respective responsibilities pursuant to a delegation agreement with New York Stock Exchange LLC ("NYSE Delegation Agreement"). PCX Holdings, Inc. ("PCX Holdings") will remain a wholly owned subsidiary of Archipelago. The Pacific Exchange, Inc. ("Pacific Exchange") will remain a wholly owned subsidiary of PCX Holdings. Archipelago

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Commission hold a public hearing on the proposed rule change. See IBAC February Letter, supra note 6, at 9.

36 Amendment Nos. 2, 4, and 7 were withdrawn by the NYSE.

37 See 17 CFR 240.19b-4(l), which requires that an SRO post a proposed rule change and any amendments thereto on the SRO's Web site within two days after the filing of the proposed rule change, and any amendments thereto.

also will continue to own Archipelago Exchange, L.L.C., the equities trading facility of the Pacific Exchange ("ArcaEx").

The Merger will have the effect of converting the NYSE from a New York not-for-profit entity into a for-profit entity and demutualizing the NYSE by separating equity ownership in the NYSE from trading privileges on the NYSE.

Through the Merger, Archipelago will become a wholly owned subsidiary of NYSE Group. The governing documents of Archipelago will remain unchanged other than amendments required to permit NYSE Group to own all of the outstanding shares of Archipelago.[38] The Merger will have no effect on the right of any party to trade securities on the trading facilities of the Pacific Exchange, including ArcaEx.

This proposed rule change, as amended, is necessary to effectuate the consummation of the Merger.[39]

A. Corporate Reorganization

In connection with the Merger, the NYSE proposes to reorganize so that the NYSE Group will be a for-profit, publicly traded stock corporation and the holding company for the businesses of the NYSE and Archipelago. NYSE Group will hold all of the equity interests in

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[38] These amendments are the subject of a proposed rule change filed by the Pacific Exchange, which proposed rule change the Commission is approving today. See Securities Exchange Act Release Nos. 53077 (January 9, 2006), 71 FR 2095 (January 12, 2006) (notice), and 53383 (February 27, 2006) (approval order).

[39] One commenter states that its concern that the NYSE intends to phase out the auction market completely in the context of the NYSE's Hybrid proposal (see Securities Exchange Act Release No. 51906 (June 22, 2005), 70 FR 37463 (June 29, 2005)) has grown since the announcement of the NYSE's proposed Merger. IBAC February Letter, supra note 6, at 13. The Commission notes that the NYSE has not proposed any substantive changes to its trading market structure or trading rules in this rule filing, and that any future changes to its trading market structure or its trading rules would need to be filed with the Commission pursuant to Section 19(b) of the Act.

New York Stock Exchange LLC and Archipelago. The current NYSE businesses and assets will be held in New York Stock Exchange LLC, NYSE Market, and NYSE Regulation.

New York Stock Exchange LLC will be a direct, wholly owned subsidiary of NYSE Group[40] and will be the successor to the registration of the NYSE as a national securities exchange.[41] The NYSE represents that New York Stock Exchange LLC is not expected to hold any material assets other than all of the equity interests of NYSE Market and NYSE Regulation.

After the Merger, there will be "members" and "member organizations" of the New York Stock Exchange LLC. However, such members or member organizations by virtue of their membership will not be equity owners of NYSE Group or any of its subsidiaries. Organizations that obtain licenses to trade on NYSE Market ("Trading Licenses") will be member organizations.[42] In addition, broker-dealers that submit to the jurisdiction and rules of New York Stock Exchange LLC, without obtaining a Trading License and thus without having rights to directly access the trading facilities of NYSE Market, will be member organizations.

NYSE Market will be a wholly owned subsidiary of New York Stock Exchange LLC.

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40 The New York Limited Liability Company Act, under which New York Stock Exchange LLC is organized, uses the term "members" to describe those that have rights, including a share of the profits and losses of the company, to receive distributions from the company, and the right to vote and participate in the management of the company. NYSE Group will be the sole "member" of New York Stock Exchange LLC within the meaning of the New York Limited Liability Company Act, but this term should not be confused with the concept of a member or member organization of New York Stock Exchange LLC under its rules and for purposes of Section 6 of the Act. To avoid confusion, NYSE Group will be referred to as the "sole owner" of New York Stock Exchange LLC.

41 In connection with the reorganization, the NYSE proposes to eliminate its Constitution and to include in the rules of New York Stock Exchange LLC relevant provisions of the NYSE Constitution.

42 See infra notes 197 to 216 and accompanying text for a discussion of Trading Licenses.

After the Merger, NYSE Market will hold all of the assets and liabilities currently held by the NYSE, other than the NYSE's registration as a national securities exchange and the assets and liabilities relating to regulatory functions. The market functions of New York Stock Exchange LLC will be delegated pursuant to the NYSE Delegation Agreement to NYSE Market, which will conduct the exchange business that is currently conducted by the NYSE and will issue Trading Licenses, which are described below.

NYSE Regulation, a New York Type A not-for-profit corporation, will be a wholly owned subsidiary of New York Stock Exchange LLC. After the Merger, NYSE Regulation will hold all of the assets and liabilities related to the regulatory functions currently conducted by the NYSE. Pursuant to the NYSE Delegation Agreement, NYSE Regulation will perform the regulatory functions of New York Stock Exchange LLC. NYSE Regulation also will perform many of the regulatory functions of the Pacific Exchange pursuant to a regulatory services agreement.

1. NYSE Group

Following the closing of the Merger, NYSE Group will be the sole owner of New York Stock Exchange LLC. Section 19(b) of the Act[43] and Rule 19b-4 thereunder[44] require an SRO to file proposed rule changes with the Commission. Although NYSE Group is not an SRO, certain provisions of its certificate of incorporation and bylaws are rules of an exchange[45] if they are

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43 15 U.S.C. 78s(b).

44 17 CFR 240.19b-4.

45 See Section 3(a)(27) of the Act, 15 U.S.C. 78c(a)(27). If NYSE Group decides to change its Certificate of Incorporation or Bylaws, NYSE Group must submit such change to the board of directors of the New York Stock Exchange LLC, NYSE Market, NYSE Regulation, the Pacific Exchange, and PCX Equities, Inc. ("PCX Equities"), and if any such boards of directors determines that such amendment is

stated policies, practice, or interpretations, as defined in Rule 19b-4 of the Act,[46] of the exchange, and must be filed with the Commission pursuant to Section 19(b) of the Act[47] and Rule 19b-4 thereunder.[48] Accordingly, the NYSE has filed the proposed Amended and Restated Certificate of Incorporation of NYSE Group ("NYSE Group Certificate of Incorporation") and the proposed Amended and Restated Bylaws of NYSE Group ("NYSE Group Bylaws") with the Commission.

a. Board of Directors

Because the directors of NYSE Group will also serve on the boards of New York Stock Exchange LLC, NYSE Market, and NYSE Regulation, the composition of, and selection process for, the NYSE Group's board of directors is described below. The NYSE Group board of directors will consist of a number of directors set by the NYSE Group board of directors, and may include its chief executive officer. The initial term of directors will end with the first annual meeting of shareholders held by NYSE Group. Thereafter, the directors will serve one-year terms.

Except for the NYSE Group board immediately following the closing of the Merger, nominees to the NYSE Group board of directors will be recommended by the nominating and

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required to be filed with or filed with and approved by the Commission pursuant to Section 19 of the Act and the rules thereunder, such change shall not be effective until filed with or filed with and approved by the Commission, as applicable. See proposed NYSE Group Certificate of Incorporation, Article XIII and NYSE Group Bylaws, Article VII, Section 7.9.

46 17 CFR 240.19b-4.

47 15 U.S.C. 78s(b).

48 17 CFR 240.19b-4.

governance committee of the NYSE Group board of directors.[49] The nominating and governance committee will consider shareholder and public investor recommendations for candidates for the NYSE Group board of directors. Directors will be elected by the NYSE Group shareholders at each annual meeting of shareholders.[50] The NYSE represents that the vast majority of the NYSE Group board of directors immediately after the closing of the Merger will be the current NYSE board of directors.[51]

Each member of the NYSE Group board of directors, other than the chief executive officer,[52] must be independent from (i) NYSE Group and its subsidiaries, (ii) any member or member organization of New York Stock Exchange LLC or the Pacific Exchange,[53] and (iii) any company whose securities are listed on New York Stock Exchange LLC or the Pacific Exchange. The independent nature of the NYSE Group board of directors is modeled on the current Commission-approved structure of the NYSE board of directors.[54] The proposed independence policy of the NYSE Group board of directors is similar to the NYSE's current independence

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49 Telephone conversation between James F. Duffy, Senior Vice-President and Deputy General Counsel, NYSE, and Kim M. Allen, Special Counsel, Division of Market Regulation ("Division"), Commission, on February 15, 2006.

50 See proposed NYSE Group Certificate of Incorporation, Article VI, Section 4.

51 See Amendment No. 8, supra note 9.

52 The chairman of the board of directors may be the chief executive officer of NYSE Group. If the chairman is not the chief executive officer, then he or she must satisfy the board's independence criteria.

53 This includes non-member broker-dealers that engage in business involving substantial direct contact with securities customers.

54 See Securities Exchange Act Release No. 48946 (December 17, 2003), 68 FR 74678 (December 24, 2003) ("NYSE 2003 Governance Approval Order").

policy,[55] but has been expanded to cover relationships with the Pacific Exchange and its affiliates, and the members and member organizations and listed companies of the Pacific Exchange.

The NYSE Group board of directors may create one or more committees. It is expected that, upon completion of the Merger, the NYSE Group board of directors will have an audit committee, a human resource and compensation committee, and a nominating and governance committee. Committees of the NYSE Group board of directors will not include the chief executive officer and therefore will consist solely of directors meeting the independence requirements of NYSE Group. These committees also will perform relevant functions for New York Stock Exchange LLC, NYSE Market, and NYSE Regulation, as described below.

b. Voting and Ownership Limitations; Changes in Control of New York Stock Exchange LLC

The proposed NYSE Group Certificate of Incorporation includes restrictions on the ability to vote and own shares of stock of NYSE Group. Under the proposed NYSE Group Certificate of Incorporation, no person (either alone or together with its related persons[56]) will be entitled to vote or cause the voting of shares of stock of NYSE Group representing in the aggregate more than 10% of the total number of votes entitled to be cast on any matter, and no person (either alone or together with its related persons) may acquire the ability to vote more than 10% of the aggregate number of votes being cast on any matter by virtue of agreements

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55 See Securities Exchange Act Release No. 51217 (February 16, 2005), 70 FR 9688 (February 28, 2005) ("NYSE Independence Policy Approval Order").

56 See proposed NYSE Group Certificate of Incorporation, Article V, Section 1(E) and note 12 of the Notice for the definition of "related person."

entered into with other persons not to vote shares of NYSE Group's outstanding capital stock. NYSE Group will disregard any such votes purported to be cast in excess of these limitations.[57]

In addition, no person (either alone or together with its related persons) may at any time 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.[58] In the event that a person, either alone or together with its related persons, beneficially owns shares of stock of NYSE Group in excess of the 20% threshold, such person and its related persons will be obligated to sell, and NYSE Group will be obligated to purchase, to the extent that funds are legally available for such purchase, that number of shares necessary to reduce the ownership level of such person and its related persons to below the permitted threshold, after taking into account that such repurchased shares will become treasury shares and will no longer be deemed to be outstanding.[59]

NYSE also has proposed to permit the NYSE Group board of directors to require any person and its related persons that the board reasonably believes to own beneficially an aggregate of five percent (5%) or more of the then outstanding shares of NYSE Group stock to provide NYSE Group with information regarding such ownership upon the board of directors' request.[60] This requirement will allow NYSE Group to monitor potential changes in control to ensure that none of the limits are reached.

The NYSE Group board of directors may waive the provisions regarding voting and ownership limits after making certain determinations, including that such person is not subject to

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57 See proposed NYSE Group Certificate of Incorporation, Article V, Section 1(A).

58 See proposed NYSE Group Certificate of Incorporation, Article V, Section 2(A).

59 See proposed NYSE Group Certificate of Incorporation, Article V, Section 2(D).

60 See proposed NYSE Group Certificate of Incorporation, Article V, Section 4.

any statutory disqualification as defined in Section 3(a)(39)[61] of the Act.[62] Any such waiver must be filed with and approved by the Commission under Section 19[63] of the Act.[64] However, for so long as NYSE Group directly or indirectly controls New York Stock Exchange LLC or NYSE Market, the NYSE Group board of directors cannot waive the voting and ownership limits above the 20% threshold if such person or its related persons is a member or member organization of New York Stock Exchange LLC.[65] In addition, for so long as NYSE Group directly or indirectly controls the Pacific Exchange, PCX Equities or any facility of the Pacific Exchange, the NYSE Group board of directors cannot waive the voting and ownership limits above the 20% threshold if such person or its related persons is an ETP Holder, OTP Holder or OTP Firm.[66]

Members that trade on an exchange traditionally have ownership interests in such exchange. As the Commission has noted in the past, however, a member's interest in an exchange could become so large as to cast doubt on whether the exchange can fairly and objectively exercise its self-regulatory responsibilities with respect to that member.[67] A member

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61 15 U.S.C. 78c(a)(39).

62 See proposed NYSE Group Certificate of Incorporation, Article V, Sections 1(A) and 2(C).

63 15 U.S.C. 78s.

64 See proposed NYSE Group Certificate of Incorporation, Article V, Sections 1(A) and 2(B).

65 See proposed NYSE Group Certificate of Incorporation, Article V, Sections 1(A) and 2(C).

66 Id. ETP Holder is defined in the PCX Equities rules of the Pacific Exchange. OTP Holder and OTP Firm are defined in the rules of the Pacific Exchange.

67 See Securities Exchange Act Release Nos. 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006) (File No. 10-131); 51149 (February 8, 2005), 70 FR 7531 (February 14, 2005) (SR-CHX-2004-26); 49718 (May 17, 2004), 69 FR 29611

that is a controlling shareholder of an exchange might be tempted to exercise that controlling influence by directing the exchange to refrain from, or the exchange may hesitate to, diligently monitor and surveil the member's conduct or diligently enforce its rules and the federal securities laws with respect to conduct by the member that violates such provisions. In this regard, one commenter expressed concern regarding undue influence by certain NYSE members that own a large number of seats, and thus will own substantial equity interests in NYSE Group after the Merger, noting such members would have "an influence on its board composition."[68]

In addition, as proposed, New York Stock Exchange LLC will be a wholly owned subsidiary of NYSE Group. The Operating Agreement of New York Stock Exchange LLC identifies this ownership structure. Any changes to the Operating Agreement of New York Stock Exchange LLC, including any change in the provision that identifies NYSE Group as the sole owner, must be filed with and approved by the Commission pursuant to Section 19 of the Act.[69] In addition, pursuant to the Operating Agreement of New York Stock Exchange LLC, NYSE Group may not transfer or assign its interest in New York Stock Exchange LLC, in whole or part, to any entity, unless such transfer or assignment is filed with and approved by the Commission under Section 19 of the Act.[70] Further, NYSE Group may resign from New York Stock Exchange LLC only if an additional owner is admitted to New York Stock Exchange LLC.

(May 24, 2004) (SR-PCX-2004-08); 49098 (January 16, 2004), 69 FR 3974 (January 27, 2004) (SR-Phlx-2003-73); and 49067 (January 13, 2004), 69 FR 2761 (January 20, 2004) (SR-BSE-2003-19).

68 IBAC February Letter, supra note 6, at 6. The commenter pointed to prior charges of regulatory favoritism by SROs (citing in part to a comment letter on the Concept Release Concerning Self-Regulation). Id.

69 15 U.S.C. 78s.

70 See proposed Operating Agreement of New York Stock Exchange LLC, Article III, Section 3.03.

The resignation of NYSE Group and the admission of a replacement member (or admission of an additional member, without NYSE Group's resignation) must be filed with and approved by the Commission under Section 19 of the Act.[71]

The Commission finds the ownership and voting restrictions in the NYSE Group Certificate of Incorporation and the change in control provisions in the Operating Agreement of New York Stock Exchange LLC are consistent with the Act. These requirements should minimize the potential that a person could improperly interfere with or restrict the ability of the Commission, New York Stock Exchange LLC, or its subsidiaries to effectively carry out their regulatory oversight responsibilities under the Act.

2. New York Stock Exchange LLC and Its Subsidiaries

a. New York Stock Exchange LLC

The New York Stock Exchange LLC board of directors will consist of a number of directors to be set by NYSE Group, as the sole owner of New York Stock Exchange LLC. All directors of New York Stock Exchange LLC must qualify as independent under the independence policy of the NYSE Group board of directors. A majority of the directors of New York Stock Exchange LLC will be directors of the NYSE Group (other than its chief executive officer), and twenty percent (20%), and not less than two, of the directors will be chosen by the members of New York Stock Exchange LLC ("LLC Fair Representation Directors").[72] The New

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71 See proposed Operating Agreement of New York Stock Exchange LLC, Article III, Sections 3.04 and 3.05.

72 The NYSE amended the New York Stock Exchange LLC board composition in Amendment No. 8 to provide that a majority of the New York Stock Exchange LLC directors will be NYSE Group directors (other than the chief executive officer). The NYSE had previously proposed that all NYSE Group directors (other than the chief executive officer) would be on the New York Stock Exchange LLC board.

York Stock Exchange LLC board of directors also may include other directors that are not NYSE Group directors ("Non-Affiliated LLC Directors").

NYSE Group will be obligated to appoint or elect as LLC Fair Representation Directors those candidates who are recommended jointly by the NYSE Market Director Candidate Recommendation Committee ("NYSE Market DCRC")[73] and the NYSE Regulation Director Candidate Recommendation Committee ("NYSE Regulation DCRC"),[74] including those candidates who emerge from the petition process of New York Stock Exchange LLC members (as described below).[75] If the New York Stock Exchange LLC board of directors includes Non-Affiliated LLC Directors, the nominating and governance committee of the NYSE Group board of directors will nominate candidates for such positions, and NYSE Group will appoint or elect such candidates as directors.

Immediately following the closing of the Merger, however, the New York Stock Exchange LLC board of directors will not include any LLC Fair Representation Directors because the process for choosing these directors will not have taken place. Accordingly,

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73 On an annual basis, the NYSE Market board of directors will appoint a NYSE Market DCRC comprised of representatives of upstairs firms, specialists, and floor brokers.

74 On an annual basis, the NYSE Regulation board of directors will appoint a NYSE Regulation DCRC comprised of representatives of upstairs firms, specialists, and floor brokers.

75 See infra notes 98 to 100 and accompanying text. One commenter believes that the fair representation candidate recommendation process is extremely complex and confusing, questioning in particular how this process will work in practice if the two DCRC committees cannot agree on joint recommendations. SIA/TBMA Letter, supra note 6, at 18. The NYSE believes that, as a practical matter, there will be no conflicts between the two committees because they will act as one committee in making recommendations for LLC Fair Representation Directors and it is expected that the two committees will be comprised of the same persons. See NYSE Response to Comments, supra note 7, at 14.

initially, it is expected that the New York Stock Exchange LLC board of directors will be comprised solely of NYSE Group directors.[76] As noted above, the vast majority of the initial NYSE Group directors will be the current NYSE board. These directors were elected by current NYSE members following a nomination process that permits the industry members of the NYSE Board of Executives to recommend 20% of the nominees and members to petition for alternate nominees. No New York Stock Exchange LLC members participated in the selection of directors for the initial board because New York Stock Exchange LLC does not yet have members. In light of these circumstances, and the NYSE's representation that the LLC Fair Representation Directors will be chosen by members and elected by NYSE Group as promptly as possible following the Merger,[77] the Commission believes that the proposed composition of the initial New York Stock Exchange LLC board of directors is consistent with the Act.

The Operating Agreement of New York Stock Exchange LLC permits the board of directors to delegate its powers to a committee appointed by the board which may consist partly or entirely of non-directors. The NYSE stated, however, that the board of directors of New York

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76 Although the size of the New York Stock Exchange LLC board will be fixed from time to time by NYSE Group, the NYSE represents that the board of directors of New York Stock Exchange LLC is not expected to have more than ten directors. See Amendment No. 8, supra note 9.

77 The NYSE represented that the individuals who will serve on the initial NYSE Market DCRC and NYSE Regulation DCRC will be identified and meet informally prior to the closing of the Merger, so that promptly thereafter these committees may be formally constituted and recommend candidates for LLC Fair Representation Directors. Following the petition process, infra notes 98 to 100 and accompanying text, NYSE Group will promptly elect to the board candidates for LLC Fair Representation Directors chosen by members. Such election will occur no later than (and may occur prior to) the annual meeting of New York Stock Exchange LLC, which is expected to be held in June 2006. These directors will serve until the New York Stock Exchange LLC annual meeting in 2007. See Amendment No. 8, supra note 9.

Stock Exchange LLC is not expected to have its own committees and that any necessary functions with respect to audit, compensation, nomination, and governance will be performed by the relevant committees of the NYSE Group board of directors.

b. NYSE Market

The NYSE Market board of directors will consist of a number of directors to be set by New York Stock Exchange LLC, as the sole equity owner of NYSE Market.[78] In addition, the board of directors will be composed as follows:

- The chief executive officer of NYSE Group will be a director of NYSE Market;
- A majority of the directors of NYSE Market will be NYSE Group directors (excepting the chief executive officer); and
- Twenty percent (20%), and not less than two, of the NYSE Market directors will be directors chosen by the members of New York Stock Exchange LLC ("Market Fair Representation Directors").

The NYSE Market board of directors also may include other directors that are not NYSE Group directors ("Non-Affiliated Market Directors"). The Market Fair Representation Directors and the Non-Affiliated Market Directors do not need to be independent, and must meet all status or constituent affiliation qualifications prescribed by any NYSE Market rule or policy filed with the Commission.[79]

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78 In Amendment No. 8, the NYSE proposes to eliminate the set initial number of directors. See Amendment No. 8, supra note 9.

79 The SIA and TBMA in their comment letter questioned whether "status or constituent affiliation qualifications" refers to qualifications that applied to member directors prior to 2003. SIA/TBMA Letter, supra note 6, at note 24. The NYSE notes that the reference refers to qualifications that may be filed with the Commission in the future, and that it does not have any proposed qualifications filed with the Commission at this

New York Stock Exchange LLC will be obligated to appoint or elect as Market Fair Representation Directors, those candidates who are recommended by the NYSE Market DCRC, including those who emerge from the petition process of New York Stock Exchange LLC members (as described below).[80] If the NYSE Market board of directors includes Non-Affiliated Market Directors, the nominating and governance committee of the NYSE Group board of directors will nominate candidates for such positions, and New York Stock Exchange LLC will appoint or elect such candidates as directors.

Immediately following the closing of the Merger, however, the process for choosing Market Fair Representation Directors will not have taken place, and the NYSE Market board of directors will not include any Market Fair Representation Directors. Accordingly, immediately following the closing of the Merger, the NYSE Market board of directors will be comprised of the chief executive officer of NYSE Group and NYSE Group directors, and is expected to have only one Non-Affiliated Market Director.[81] As noted above, the vast majority of the initial NYSE Group directors will be the current NYSE board. These directors were elected by current NYSE members following a nomination process that permits the industry members of the NYSE Board of Executives to recommend 20% of the nominees and members to petition for alternate nominees. No New York Stock Exchange LLC members participated in the selection of

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time. NYSE Response to Comments, supra note 7, at note 13 and telephone conversation between James F. Duffy, Senior Vice-President and Deputy General Counsel, NYSE, et al., and Heather A. Seidel, Senior Special Counsel, Commission, Division, et al., on February 10, 2006.

80 See infra notes 98 to 100 and accompanying text.

81 See Amendment No. 8, supra note 9. Although the size of NYSE Market board will be fixed from time to time by New York Stock Exchange LLC, the NYSE represents that the board of directors of NYSE Market is not expected to have more than ten directors. See Amendment No. 8, supra note 9.

directors for the initial board because New York Stock Exchange LLC does not yet have members. In light of these circumstances, and the NYSE's representation that the Market Fair Representation Directors will be chosen by members and elected by New York Stock Exchange LLC as promptly as possible following the Merger,[82] the Commission believes that the proposed composition of the initial NYSE Market board of directors is consistent with the Act.

The NYSE Market board of directors may create one or more committees comprised of NYSE Market directors. The NYSE has represented that it expects that the committees of the NYSE Group board of directors will perform the committee functions relating to audit, governance, nomination, and compensation. The NYSE Market board of directors also may create committees comprised in whole or in part of individuals who are not directors.

The NYSE has represented that upon completion of the Merger, the NYSE Market board of directors will establish one or more advisory committees to facilitate communication and provide input to the board of directors, management, and staff of NYSE Market and its affiliated entities on policies, programs, products, and services. The NYSE Market board of directors will create a Market Performance Committee comprised of representatives of member organizations.

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82 The NYSE represented that the individuals who will serve on the initial NYSE Market DCRC will be identified and meet informally prior to the closing of the Merger, so that promptly thereafter this committee may be formally constituted and recommend candidates for Market Fair Representation Directors. Following the petition process, infra notes 98 to 100 and accompanying text, New York Stock Exchange LLC will promptly elect to the board of NYSE Market candidates for Market Fair Representation Directors chosen by members. Such election will occur no later than (and may occur prior to) the annual meeting of NYSE Market, which is expected to be held in June 2006. These directors will serve until the annual meeting of NYSE Market in 2007. See Amendment No. 8, supra note 9.

The Market Performance Committee will act in an advisory capacity regarding trading rules and other matters to be specified in its charter.[83]

The officers of NYSE Market will manage the business and affairs of NYSE Market, subject to the oversight by the NYSE Market board of directors. The chief executive officer of NYSE Group will serve as the chief executive officer of NYSE Market (and as a director of NYSE Market).

c. NYSE Regulation

The NYSE Regulation board of directors will consist of a number of directors to be set by New York Stock Exchange LLC, as the sole equity owner of NYSE Regulation.[84] The chief executive officer of NYSE Regulation will be a director of NYSE Regulation[85] and a majority of the directors of NYSE Regulation will be persons who are not NYSE Group directors, but who otherwise qualify as independent under the independence policy of the NYSE Group board of directors ("Non-Affiliated Regulation Directors").[86] Except for the NYSE Regulation board of directors immediately following the closing of the Merger, 20%, and not less than two, of the NYSE Regulation directors will be chosen by the members of New York Stock Exchange LLC ("Regulation Fair Representation Directors").[87] The remaining NYSE Regulation directors will be NYSE Group directors (other than its chief executive officer).

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83 See proposed NYSE Rule 20(b). In connection with establishing these advisory committees, the NYSE proposes to eliminate references to the Board of Executives from the rules of the exchange.

84 In Amendment No. 8, the NYSE proposes to eliminate the set initial number of directors. See Amendment No. 8, supra note 9.

85 See infra note 89 and accompanying text.

86 See Amendment No. 6, supra note 8.

87 The Fair Representation Directors will compose part of the majority that are Non-Affiliated Regulation Directors.

New York Stock Exchange LLC will be obligated to appoint or elect as Regulation Fair Representation Directors those candidates who are recommended by the NYSE Regulation DCRC, including those candidates who emerge from the petition process of New York Stock Exchange LLC members (as described below).[88] Non-Affiliated Regulation Directors will be nominated by the nominating and governance committee of NYSE Regulation. New York Stock Exchange LLC will appoint or elect such nominees to the board of directors of NYSE Regulation.

Immediately following the closing of the Merger, the NYSE Regulation board of directors will be comprised of three Non-Affiliated Directors and two NYSE Group directors. There will be no Regulation Fair Representation Directors because, as discussed above, the process for choosing such directors will no yet have taken place. The board of directors will, however, have a majority of Non-Affiliated Regulation Directors. The chief executive officer of NYSE Regulation will not become a member of the board of directors of NYSE Regulation until the Regulation Fair Representation Directors are elected to that board.[89]

Prior to the closing of the Merger, the NYSE's current nominating and governance committee will select directors to serve as the three Non-Affiliated Directors on the initial NYSE Regulation board.[90] The directors on NYSE's nominating and governance committee were elected by current NYSE members following a nomination process that permits the industry members of the NYSE Board of Executives to recommend 20% of the nominees and members to

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88 See infra notes 98 to 100 and accompanying text.

89 See Amendment No. 8, supra note 9.

90 The current NYSE nominating and governance committee is comprised of all of the independent directors on the current NYSE board. The current NYSE board is composed of only independent directors, plus the chief executive officer of the NYSE.

petition for alternate nominees. No New York Stock Exchange LLC members participated in the selection of directors for the initial board because it does not yet have members. Moreover, NYSE Regulation does not yet have a nominating and governance committee to nominate candidates to serve as Non-Affiliated Directors. Prior to the first annual meeting of NYSE Regulation, the NYSE Regulation nominating and governance committee will be required, pursuant to the proposed NYSE Regulation Bylaws, to nominate Non-Affiliated Directors to be elected at the first annual meeting, which is expected to occur no later than June 2006. In light of these circumstances, and the NYSE's representation that the Regulation Fair Representation Directors will be chosen by members and elected by New York Stock Exchange LLC as promptly as possible following the Merger,[91] the Commission believes that the proposed composition of the initial NYSE Regulation board of directors is consistent with the Act.

The NYSE Regulation board of directors may create one or more committees comprised of NYSE Regulation directors. It will create a nominating and governance committee and a compensation committee, each of which will be comprised of a majority of Non-Affiliated Regulation Directors. The compensation committee will be responsible for setting the compensation for NYSE Regulation employees.[92] The nominating and governance committee

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91 The NYSE represented that the individuals who will serve on the initial NYSE Regulation DCRC will be identified and meet informally prior to the closing of the Merger, so that promptly thereafter this committee may be formally constituted and recommend candidates for Regulation Fair Representation Directors. Following the petition process, infra notes 98 to 100 and accompanying text, New York Stock Exchange LLC will promptly elect to the board candidates for Regulation Fair Representation Directors chosen by members. Such election will occur no later than (and may occur prior to) the annual meeting of NYSE Regulation, which is expected to be held in June 2006. These directors will serve until the annual meeting of NYSE Regulation in 2007. See Amendment No. 8, supra note 9.

92 See Amendment No. 6, supra note 8.

will bear responsibility for nominating Non-Affiliated Regulation Director candidates. The NYSE has represented that it is expected that the audit committee of the NYSE Group board of directors will perform the board committee functions relating to audit.

The NYSE Regulation board of directors also may create committees comprised in whole or in part of individuals who are not directors. The NYSE Regulation board of directors will appoint a committee that, among other things, will review disciplinary decisions on behalf of the NYSE Regulation board of directors ("Committee for Review").[93] This committee will be comprised of directors of NYSE Regulation that satisfy the independence requirements (thus, any NYSE Regulation director, other than the chief executive officer), as well as persons who are not directors. A majority of the members of the Committee for Review voting on a matter must be directors of NYSE Regulation. Among the persons on the Committee for Review who are not directors, will be included representatives of member organizations that engage in a business involving substantial direct contact with securities customers (upstairs firms), specialists, and floor brokers.[94] In addition, the NYSE Regulation board of directors will create a Regulatory Advisory Committee, which will include representatives of member organizations. The Regulatory Advisory Committee will act in an advisory capacity regarding disciplinary matters and regulatory rules other than trading rules.[95]

The NYSE has represented that upon completion of the Merger, the NYSE Regulation board of directors is expected to establish one or more additional advisory committees to

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93 This committee will be the successor committee to the current regulation, enforcement, and listing standards committee ("RELS Committee"). See infra note 192 and accompanying text.

94 See proposed NYSE Regulation Bylaws, Article III, Section 5.

95 See proposed NYSE Rule 20(b).

facilitate communication and provide input to the board of directors, management, and staff of NYSE Regulation and its affiliated entities on policies, programs, regulatory aspects of products, and services.

d. Fair Representation of New York Stock Exchange LLC Members

Section 6(b)(3) of the Act[96] requires that the rules of an exchange assure fair representation of its members in the selection of its directors and administration of its affairs. This requirement helps to ensure that members have a voice in the self-regulatory authority and that the exchange is administered in a way that is equitable to all those who trade on its market or through its facilities. As discussed below, the Commission believes that the NYSE's proposed requirement that 20% of the directors of the boards of directors of New York Stock Exchange LLC, NYSE Market, and NYSE Regulation be chosen by members and the means by which they will be chosen satisfies the fair representation of members in the selection of directors and the administration of the exchange consistent with the requirements in Section 6(b)(3) of the Act.[97]

The DCRC committees, composed of member representatives, will nominate candidates to be LLC Fair Representation Directors, Market Fair Representation Directors, and Regulation Fair Representation Directors. In addition, members will be able to nominate directly candidates to be Fair Representation Directors through a petition process.

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96 15 U.S.C. 78f(b)(3).

97 Id. The Commission does not believe that there is only one method to satisfy the fair representation requirements of Section 6(b)(3) of the Act, and reviews each SRO proposal on its own terms to determine if it is consistent with the Act.

Specifically, member organizations may nominate candidates by submitting a petition signed by at least ten percent (10%) of the eligible signatures.[98] No member organization, together with its affiliates, may account for more than fifty percent (50%) of the signatures endorsing a particular candidate.[99] If the number of candidates after the petition process is greater than 20% (or two) of the total number of members on the board of directors of New York Stock Exchange LLC, NYSE Market, and NYSE Regulation, as applicable, then the member organizations will vote on the candidates.[100] No member organization, either alone or together with its affiliates, may account for more than 20% of the votes cast for a particular candidate. The candidates receiving the highest number of votes will become the Fair Representation Directors.

The Commission believes that members' participation on various committees, including the Market Performance Committee of the NYSE Market, and the Regulatory Advisory

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98 For a candidate for the New York Stock Exchange LLC board of directors or the NYSE Regulation board of directors, each member organization is entitled to one signature for each Trading License owned by it, and each member organization that does not own a Trading License is entitled to one signature. For a candidate for the NYSE Market board of directors, each member organization is entitled to one signature for each Trading License owned by it, and a member organization that does not own a Trading License is not entitled to sign a petition.

99 See proposed Operating Agreement of New York Stock Exchange LLC, Article II, Section 2.03(iv), proposed Bylaws of NYSE Market ("NYSE Market Bylaws"), Article III, Section 1(C), and proposed NYSE Regulation Bylaws, Article III, Section 1(C).

100 For a candidate for the New York Stock Exchange LLC board of directors or the NYSE Regulation board of directors, each member organization is entitled to one vote for each Trading License owned by it, and each member organization that does not own a Trading License is entitled to one vote. For a candidate for the NYSE Market board of directors, each member organization is entitled to one vote for each Trading License owned by it, and a member organization that does not own a Trading License is not entitled to vote.

Committee and Committee for Review of NYSE Regulation, further provides for the fair representation of members in the administration of the affairs of the exchange, including rulemaking and the disciplinary process, consistent with Section 6(b)(3) of the Act.[101]

In their joint comment letter on the proposed rule change, the SIA and TBMA state that the requirement that all New York Stock Exchange LLC and NYSE Regulation directors, including the 20% selected by the membership, be independent, as well as the way that "independence" is defined, does not comport with the "fair representation" requirement.[102] They also do not believe that such a structure is desirable from a policy perspective because it will exclude nearly all persons with significant and recent industry experience, which will result in inferior regulatory oversight.[103] The SIA and TBMA further believe that the need for direct member representation on these boards is heightened in a for-profit structure, particularly when directors of the for-profit parent, NYSE Group, are heavily represented on, or dominate, the exchange and regulatory boards.[104] They are concerned about conflicts of interest between the

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101 15 U.S.C. 78f(b)(3). Each of the Market Performance and Regulatory Advisory Committees will include representatives of member organizations that do business on the floor and those that do not. The Market Performance Committee shall act in an advisory capacity regarding trading rules and other matters within its charter, and the Regulatory Advisory Committee shall act in an advisory capacity regarding disciplinary matters and regulatory rules other than trading rules. See proposed NYSE Rule 20(b). The Committee for Review, which will hear disciplinary appeals on behalf of the NYSE Regulation board of directors, will be composed of NYSE Regulation directors and member representatives. See NYSE Regulation Bylaws, Article III, Section 5. See also infra note 192 and accompanying text.

102 SIA/TBMA Letter, supra note 6, at 11.

103 Id. at 14-16.

104 The SIA and TBMA note that other demutualized SROs allow for direct member representation on their boards of directors. Id. at 12-13. The Commission does not believe that there is only one method to satisfy the fair representation requirements of

exchange's commercial interests and its regulatory responsibilities, particularly its regulation of members that are its competitors, and believe that such direct member representation is necessary to act as a "check against the [e]xchange misusing its regulatory power to gain advantage over its competitors."[105] Another commenter also questions whether the proposed structure meets the fair representation requirements of the Act, noting that NYSE Group's board lacks any industry input and that other boards or committees may have only token participation.[106]

The Commission believes that the fair representation requirement would not prohibit exchanges and associations from having boards of directors composed solely of independent directors, and that if a board of directors is composed wholly of independent directors, the candidate or candidates selected by members would have to be independent. The Commission also notes that it previously approved the NYSE's fully independent board, finding that such a board could be consistent with the Act and the fair representation and issuer and investor

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Section 6(b)(3) of the Act, and reviews each SRO proposal on its own terms to determine if it is consistent with the Act.

105 Id. at 11-12. See also infra discussion in Section II.C. on the independence of the exchange's regulatory function.

The SIA and TBMA, noting that the question of whether self-regulation remains a viable concept was posed by the Commission in the Concept Release Concerning Self-Regulation, believe that approval of the NYSE's proposal would be "tantamount" to the Commission concluding that members should not exercise a meaningful voice in regulating their business activities through existing SROs. Id. at 12. The Commission notes that its responsibility is to determine whether the NYSE's instant proposal is consistent with the Act, and that if the Commission were in the future to take action on the issue of whether the self-regulatory structure of the U.S. securities markets remains a viable structure, such action would impact all SROs.

106 Nasdaq February Letter, supra note 6, at 6-7. The Commission notes that it has not required the board of directors of a holding company of an exchange to satisfy the requirements of Section 6(b)(3) of the Act. See, e.g., Securities Exchange Act Release No. 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006).

representation requirements.[107] The Commission recognizes the SIA's and TBMA's concern regarding potential heightened conflicts in a for-profit entity between an exchange's commercial interests and its regulation of members that are competitors. It would be a violation of the Act if the NYSE Regulation board were to advance the commercial interests of the NYSE Group at the expense of fulfilling New York Stock Exchange LLC's regulatory obligations.[108] The Commission finds that overall the composition of and selection process for the NYSE Regulation board of directors, as well as the New York Stock Exchange LLC and NYSE Market boards of directors, are consistent with Section 6(b)(3) of the Act,[109] and would permit the exchange to carry out its obligations under Section 6(b)(1) of the Act[110] to be so organized and have the capacity to be able 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 rules and regulations thereunder, and the rules of the exchange.[111]

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107 See NYSE 2003 Governance Approval Order, supra note 54. The Commission approved the current independence policy of the NYSE on February 16, 2005. See NYSE Independence Policy Approval Order, supra note 55.

108 See, e.g., Report pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding the NASD and the Nasdaq Market, August 8, 1996, available at the Commission's Web site (http://www.sec.gov/litigation/investreport/nasdaq21a.htm) ("1996 21(a) Report"), and Securities Exchange Act Release No. 51524 (April 12, 2005), available at the Commission's Web site (http://www.sec.gov/litigation/admin/34-51524.pdf) ("2005 NYSE Administrative Cease-and-Desist Proceeding").

109 15 U.S.C. 78f(b)(3).

110 15 U.S.C. 78f(b)(1).

111 One commenter recommended that to ensure that the views of the NYSE floor brokers will be heard and their interests protected, the governing documents of NYSE Group, NYSE Market, and NYSE Regulation should provide that their respective boards of directors at all times include at least one director that is currently affiliated with an active independent floor brokerage business on the NYSE floor. IBAC February Letter, supra note 6, at 22. The Commission notes that each of the DCRC committees

The SIA and TBMA also believe that NYSE's regulatory structure should ensure meaningful member representation in the rulemaking and funding processes of New York Stock Exchange LLC and NYSE Regulation, and that representation on purely advisory committees, such as the proposed Regulatory Advisory Committee, is insufficient to provide fair representation in the administration of the affairs of the exchange.[112] Specifically, the SIA and TBMA believe that the Regulatory Advisory Committee's advisory role is insufficient since its recommendations are non-binding, and that the mandate of the Committee is too narrow because it has no authority over rulemaking, spending, funding, or budget decisions of NYSE Regulation.[113] They believe that member involvement in rulemaking is essential to counter the conflicts of interest posed by a for-profit exchange regulating its members, and that member representation in funding is an appropriate safeguard against excessive fees and budgeting demands.[114] Another commenter believes that fair representation in the governance process is

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of NYSE Market and NYSE Regulation, which are responsible for recommending the "fair representation" candidates for the boards of New York Stock Exchange LLC, NYSE Market, and NYSE Regulation, must have at least two individuals each of whom is associated with a member organization and spends a majority of his time on the trading floor of NYSE Market and has as a substantial part of his business the execution of transactions on the floor for other than his own account or the account of his member organization. See NYSE Market Bylaws, Article III, Section 5, and NYSE Regulation Bylaws, Article III, Section 5. In addition, any person that holds a Trading License, including a floor broker, will be able to utilize the petition process as described in this section.

112 SIA/TBMA Letter, supra note 6, at 4.

113 Id. at 16-17. The Commission notes that proposed NYSE Rule 20(b) provides that the Regulatory Advisory Committee shall act in an advisory capacity regarding regulatory rules other than trading rules, and that the Market Performance Committee of NYSE Market shall act in an advisory capacity regarding trading rules.

114 Id. at 17-18. The SIA and TBMA also believe that it is appropriate and necessary that members participate in decisions regarding the use and allocation of funds collected from members, through membership and trading activity fees, and that member

crucial to prevent preferential treatment of certain members, and notes that the NYSE, although "concededly complying with minimum fair representation requirements," proposes to decrease the involvement of its independent constituencies in management by eliminating the Board of Executives.[115]

The Commission notes that the NYSE has proposed two specific member advisory committees, the Market Performance and the Regulatory Advisory Committees, pursuant to which members[116] will have a voice in the rulemaking process and disciplinary matters, as well as the Committee for Review, which will contain member representatives and will hear disciplinary appeals.[117] Although member participation through these committees will be advisory (except with respect to the Committee for Review), the board of NYSE Regulation will

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involvement is necessary to ensure that fees for market data and other services are cost-justified and not used to cross-subsidize other products or services. Id. at 18.

The SIA and TBMA recommend that members be represented on standing committees of New York Stock Exchange LLC, NYSE Market, and NYSE Regulation responsible for rulemaking, assessing the effectiveness of the regulatory programs and funding, as well as on the nominating, governance, and audit committees. Id. at 24.

115 IBAC February Letter, supra note 6, at 7.

116 These two committees will contain representatives of member organizations doing business on the floor of the exchange and those that do not do business on the floor. See proposed NYSE Rule 20(b).

117 See supra note 101 and accompanying text. In its response to comments, the NYSE also notes the continuing role of the Compliance Advisory Committee. NYSE Response to Comments, supra note 7, at 11. In addition, New York Stock Exchange LLC and NYSE Regulation have the ability to appoint additional advisory committees comprised of persons that are not directors. The Commission notes that in its filing, the NYSE represented that the NYSE Market and NYSE Regulation boards of directors will establish one or more advisory committees. The purpose of these advisory committees is to facilitate communication and provide input to the boards of directors, management, and staff of each of NYSE Market and NYSE Regulation and their affiliated entities on policies, programs, products, regulatory aspects of products (with respect to NYSE Regulation), and services. See supra Sections II.A.2.b. and II.A.2.c.

have to approve all rule changes of New York Stock Exchange LLC filed with the Commission. As discussed above, the Commission believes that members will have representation on the boards of directors of New York Stock Exchange LLC and NYSE Regulation (as well as NYSE Market) in compliance with the fair representation requirements of the Act. Further, the Commission notes that all proposed rule changes, including those imposing fees, must be filed by New York Stock Exchange LLC with the Commission. The Commission finds that these requirements, together with the composition of and selection process for the boards of directors of New York Stock Exchange LLC, NYSE Market, and NYSE Regulation, provide for the fair representation of members in the administration of the exchange consistent with the requirement in Section 6(b)(3) of the Act.[118]

e. Representation of Issuers and Investors

Section 6(b)(3) of the Act[119] also requires that the rules of an exchange provide that one or more directors be representative of issuers and investors and not be associated with a member of the exchange or with a broker or dealer. One commenter recommended that the Commission require that a certain number of directors on the boards of NYSE Group and its various subsidiaries be investor representatives.[120] The Commission has previously stated its belief that the inclusion of public, non-industry representatives on exchange oversight bodies is critical to an exchange's ability to protect the public interest.[121] Further, public representatives help to ensure that no single group of market participants has the ability to systematically disadvantage

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118 15 U.S.C. 78f(b)(3).

119 Id.

120 ICI Letter, supra note 6, at 2.

121 See Regulation of Exchanges and Alternative Trading Systems, Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844 (December 22, 1998).

other market participants through the exchange governance process. The Commission believes that public directors can provide unique, unbiased perspectives, which should enhance the ability of the exchange board to address issues in a non-discriminatory fashion and foster the integrity of the New York Stock Exchange LLC.

The Commission finds that the New York Stock Exchange LLC, NYSE Market, and NYSE Regulation boards of directors satisfy the issuer and investor representation requirement in Section 6(b)(3) of the Act.[122] Furthermore, in nominating candidates to serve on the boards of directors of New York Stock Exchange LLC, NYSE Market, and NYSE Regulation, the NYSE has represented that the nominating and governance committees of NYSE Group and NYSE Regulation will each nominate at least one director candidate to represent issuers and one director candidate to represent investors.[123] In addition, the Commission finds that public, non-industry representation on these boards is consistent with the Act, and in particular, Section 6(b)(1).[124]

B. Relationship of NYSE Group and its Regulated Subsidiaries; Jurisdiction over NYSE Group

Although NYSE Group will not itself carry out regulatory functions, its activities with respect to the operation of any of New York Stock Exchange LLC, NYSE Market, NYSE Regulation, ArcaEx, Pacific Exchange or PCX Equities (each, a "Regulated Subsidiary" and together, the "Regulated Subsidiaries") must be consistent with, and not interfere with, the

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122 15 U.S.C. 78f(b)(3). The Commission notes that it has not required the board of directors of a holding company of an exchange to satisfy the requirements of Section 6(b)(3) of the Act. See, e.g., Securities Exchange Act Release No. 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006).

123 See Notice, supra note 5, at note 37.

124 15 U.S.C. 78f(b)(1).

Regulated Subsidiaries' self-regulatory obligations. The proposed NYSE Group corporate documents include certain provisions that are designed to maintain the independence of the Regulated Subsidiaries' self-regulatory functions from NYSE Group, enable the Regulated Subsidiaries to operate in a manner that complies with the federal securities laws, including the objectives of Sections 6(b) and 19(g) of the Act,[125] and facilitate the ability of the Regulated Subsidiaries and the Commission to fulfill their regulatory and oversight obligations under the Act.[126]

For example, under the proposed NYSE Group Certificate of Incorporation, NYSE Group shall comply with the federal securities laws and the rules and regulations thereunder and shall cooperate with the Commission and the Regulated Subsidiaries.[127] Also, each director, officer, and employee of NYSE Group, in discharging his or her responsibilities shall comply with the federal securities laws and the rules and regulations thereunder, cooperate with the Commission, and cooperate with the Regulated Subsidiaries.[128] In addition, in discharging his or her responsibilities as a member of the board, each director of NYSE Group must, to the fullest extent permitted by applicable law, take into consideration the effect that NYSE Group's actions would have on the ability of the Regulated Subsidiaries to carry out their responsibilities under the Act.[129] NYSE Group, its directors, officers, and employees also shall give due regard to the preservation of the independence of the self-regulatory functions of the Regulated

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125 15 U.S.C. 78f(b) and 15 U.S.C. 78s(g).

126 See proposed NYSE Group Certificate of Incorporation Article VI, Section 8; Article X; Article XI; Article XII; and Article XIII. See also NYSE Group Bylaws, Article VII, Section 7.9.

127 See proposed NYSE Group Certificate of Incorporation, Article XII.

128 See proposed NYSE Group Certificate of Incorporation, Article VI, Section 8.

129 See id.

Subsidiaries.[130] Further, the NYSE Group agrees to keep confidential all confidential information pertaining to the self-regulatory function of New York Stock Exchange LLC, NYSE Market, NYSE Regulation, the Pacific Exchange, and PCX Equities, and not use such information for any commercial[131] purposes.[132]

In addition, NYSE Group's books and records will be subject at all times to inspection and copying by the Commission and, to the extent related to its operation or administration, any Regulated Subsidiary, and are deemed to be the books and records of the Regulated Subsidiaries for purposes of and subject to oversight pursuant to the Act.[133] NYSE Group, its directors and officers, and those of its employees whose principal place of business and residence is outside of

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130 See proposed NYSE Group Certificate of Incorporation, Article XII.

131 The Commission believes that any non-regulatory use of such information would be for a commercial purpose.

132 See proposed NYSE Group Certificate of Incorporation, Article XI. The NYSE Group Certificate of Incorporation states that none of its provisions shall be interpreted so as to limit or impede the rights of the Commission or any of the Regulated Subsidiaries to access and examine such confidential information pursuant to the federal securities laws and the rules and regulations thereunder, or to limit or impede the ability of any officers, directors, employees, or agents of NYSE Group to disclose such confidential information to the Commission or the Regulated Subsidiaries. Id.

The SIA and TBMA note that the NYSE Delegation Agreement provides that trading data that comes into the possession of NYSE Regulation from either New York Stock Exchange LLC or NYSE Market shall be treated as confidential and not be made available to the public. They believe this provision should be modified to clarify it is not intended to restrict access to market data, and that all trading data (other than counterparty names) should be available at cost after a brief period of time. SIA/TBMA Letter, supra note 6, at 20. The NYSE notes that this provision by its terms applies only to confidential information pertaining to the self-regulatory function of New York Stock Exchange LLC or a delegated regulatory responsibility and therefore would not apply to the type of market data that has been for years disseminated to the public. NYSE Response to Comments, supra note 7, at A-2.

133 See proposed NYSE Group Certificate of Incorporation, Article XI.

the United States, also submit to the jurisdiction of the U.S. federal courts and the Commission with respect to activities relating to the Regulated Subsidiaries.[134]

Finally, the NYSE Group Certificate of Incorporation and Bylaws require that, for so long as NYSE Group controls any of the Regulated Subsidiaries, any changes to the NYSE Group Certificate of Incorporation and Bylaws be submitted to the board directors of the New York Stock Exchange LLC, NYSE Market, NYSE Regulation, the Pacific Exchange, and PCX Equities, and if any such boards of directors determines that such amendment is required to be filed with or filed with and approved by the Commission pursuant to Section 19 of the Act[135] and the rule thereunder, such change shall not be effective until filed with or filed with and approved by, the Commission.[136] The Commission finds that these provisions are consistent with the Act, and that they will assist New York Stock Exchange LLC in fulfilling its self-regulatory obligations and in administering and complying with the requirements of the Act.

Under Section 20(a) of the Act,[137] any person with a controlling interest in New York Stock Exchange LLC and the Pacific Exchange would be jointly and severally liable with and to the same extent that New York Stock Exchange LLC and the Pacific Exchange are liable under any provision of the Act, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action. In addition, Section 20(e) of the Act[138] creates aiding and abetting liability for any person who knowingly

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134 See proposed NYSE Group Certificate of Incorporation, Article X.

135 15 U.S.C. 78s.

136 See proposed NYSE Group Certificate of Incorporation, Article XIII and NYSE Group Bylaws, Article VII, Section 7.9.

137 15 U.S.C. 78t(a).

138 15 U.S.C. 78t(e).

provides substantial assistance to another person in violation of any provision of the Act or rule thereunder. Further, Section 21C of the Act[139] authorizes the Commission to enter a cease-and-desist order against any person who has been "a cause of" a violation of any provision of the Act through an act or omission that the person knew or should have known would contribute to the violation. These provisions are applicable to NYSE Group's dealing with its Regulated Subsidiaries.

The Commission received four comment letters on the proposed rule change questioning Gerald Putnam's fitness to serve as an officer of NYSE Group or to lead the NYSE upon consummation of the Merger.[140] The issue of Mr. Putnam's fitness to serve as an officer or director of a public company or the NYSE is not before the Commission in the context of this rule filing. Pursuant to Section 19(b)(1) of the Act,[141] an SRO (such as the NYSE) is required to file with the Commission any proposed rule or any proposed change in, addition to, or deletion from the rules of such SRO. Further, pursuant to Section 19(b)(2) of the Act,[142] the Commission shall approve a proposed rule change filed by an SRO if the Commission finds that such proposed rule change is consistent with the requirements of the Act and the rules and regulations

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139 15 U.S.C. 78u-3.

140 See Borsellino Letter, Kopecky Letter, Lozman Letter, and Nathanson Letter, supra note 6. After the Merger, NYSE Group will be a publicly traded company and the holding company for the businesses of the NYSE and Archipelago. Mr. Putnam is currently the chairman of the board of directors and chief executive officer of Archipelago and the chairman of the Pacific Exchange. Upon completion of the Merger, it is intended that Mr. Putnam will be named as co-president and chief operating officer of NYSE Group. See letter from Kevin J.P. O'Hara, Chief Administrative Officer, General Counsel, and Secretary, Pacific Exchange, to Nancy M. Morris, Secretary, Commission, dated February 8, 2006.

141 15 U.S.C. 78s(b)(1).

142 15 U.S.C. 78s(b)(2).

thereunder applicable to the SRO. The NYSE is not providing in this filing for any particular person to serve as an officer or director of NYSE Group or any of its subsidiaries. In addition, Section 19(h)(4) of the Act[143] authorizes the Commission, if in its opinion such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act, to remove or censure an officer or director of a national securities exchange if it finds, after notice and opportunity for a hearing, that such officer or director has willfully violated any provision of the Act, the rules or regulations thereunder, or the rules of such exchange, willfully abused his authority, or without reasonable justification or excuse has failed to enforce compliance with any such provision by any member or person associated with a member.

C. Independence of Self-Regulatory Function

The NYSE has proposed several measures to help ensure the independence of its regulatory function from its market operations and other commercial interests. For example, all directors on the board of NYSE Regulation (other than its chief executive officer) will be required to be independent of management of NYSE Group and its subsidiaries, as well as of members and listed companies. In addition, a majority of the members of the NYSE Regulation board must be directors that are not also directors of NYSE Group. Although the NYSE will not have a regulatory oversight committee, the board of NYSE Regulation is expected to function in such capacity. Further, NYSE Regulation will have its own nominating and governance committee, rather than share the NYSE Group nominating and governance committee, and this

143 15 U.S.C. 78s(h)(4).

committee also will be composed of a majority of directors that are not also directors of NYSE Group.

The chief executive officer of NYSE Regulation will function as the exchange's chief regulatory officer. This position will report solely to the NYSE Regulation board and not to any other NYSE Group entity, although he or she may attend the board meetings of such other entities as deemed appropriate to carry out his or her responsibilities.

The NYSE also proposes to establish a separate compensation committee for NYSE Regulation. This committee also will have a majority of non-NYSE Group directors. The NYSE Regulation compensation committee will be responsible for setting the compensation for NYSE Regulation employees; thus, the NYSE Group compensation committee will not have a say in this process.

The Commission further notes that the NYSE has taken steps to safeguard the use of regulatory monies. Specifically, New York Stock Exchange LLC will not be permitted to use any assets of, or any regulatory fees, fines, or penalties collected by, NYSE Regulation for commercial purposes or distribute such assets, fees, fines, or penalties to NYSE Group or any entity other than NYSE Regulation.[144]

The Commission is concerned about potential for unfair competition and conflicts of interest between an exchange's self-regulatory obligations and its commercial interests that could exist if an exchange were to otherwise become affiliated with one of its members, as well as the potential for unfair competitive advantage that the affiliated member could have by virtue of

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144 The NYSE originally included this covenant in the NYSE Delegation Agreement. In Amendment No. 8, the NYSE deleted this provision from the NYSE Delegation Agreement and included the provision in the Operating Agreement of New York Stock Exchange LLC. The substance remains the same.

informational or operational advantages, or the ability to receive preferential treatment.[145] In the Notice, the NYSE acknowledged that ownership of, or a control relationship with, a member organization by NYSE Group or any of its subsidiaries would necessitate that the foregoing concerns be first addressed with, and to the satisfaction of, the Commission.[146] Proposed NYSE Rule 2B provides that without prior Commission approval, the exchange or any entity with which it is affiliated shall not, directly or indirectly, acquire or maintain an ownership interest in a member organization. In addition, a member organization shall not be or become an affiliate of the exchange, or an affiliate of any affiliate of the exchange.[147]

One commenter on the proposed rule change specifically expressed the view that the proposed merger is structured in a manner to safeguard the regulatory and enforcement functions of the NYSE.[148] In particular, the commenter, noting that the future location and oversight of the regulatory functions of the NYSE is a key issue, believes that the proposed rule change "presents a very thoughtful structure designed to ensure the independence of NYSE Regulation, while maintaining its closeness to the market."[149] The commenter believes that this structure will assure that the for-profit status of NYSE Group does not interfere with NYSE Regulation

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145 See Securities Exchange Act Release No. 52497 (September 22, 2005), 70 FR 56949 (September 29, 2005) (order approving Archipelago's acquisition of the Pacific Exchange).

146 The NYSE represented that it does not currently, nor after the Merger will it, own or control any of its member organizations. The NYSE also stated that to the extent that a member organization will be the owner of NYSE Group common stock, the ownership limitations described above are intended to deal with the issues that might otherwise be presented. See Notice, supra note 5, at 2084.

147 Proposed NYSE Rule 2B also provides that it does not prohibit a member organization from acquiring or holding an equity interest in NYSE Group that is permitted by the ownership limitations contained in the NYSE Group Certificate of Incorporation.

148 See NAST Letter, supra note 6.

149 Id. at 2.

meeting its duties to investors and other market participants, while promoting market-sensitive regulation.[150]

Several other commenters express concerns about potential conflicts of interest between the NYSE's self-regulatory obligations and its commercial activities, particularly in a for-profit structure. These commenters do not believe that the NYSE's proposal provides for adequate separation of such functions.[151]

The SIA and TBMA emphasize their concern that the exchange may use its regulatory power to disadvantage its competitors (i.e., its members).[152] They believe this concern is heightened with a governance structure that provides NYSE Group, the for-profit entity, control of the exchange board and a dominant role on the regulatory board (coupled with no direct member representation on those boards).[153] They also believe that, because New York Stock

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150 Id. at 2.

151 See CalPERS Letter, IBAC February Letter, ICI Letter, NASD Letter, Nasdaq February Letter, and SIA/TBMA Letter, supra note 6. See also Nasdaq Extension Letter, supra note 6.

152 SIA/TBMA Letter, supra note 6, at 3. The SIA and TBMA also note the potential for the profit motive of a shareholder-owned exchange to detract from self-regulation through, for example, insufficient funding of regulation. Id. at 6.

153 Id. at 6-7. Other commenters also point to NYSE Group's control of NYSE Regulation as a reason there is insufficient regulatory independence within the proposed structure. Nasdaq states that the selection of NYSE Regulation directors is ultimately controlled by NYSE Group. Nasdaq February Letter, supra note 6, at 5. IBAC believes that NYSE Group will have control over a majority of NYSE Regulation's board, through its appointment of the NYSE Group directors and non-NYSE Group directors (which must constitute a majority) on NYSE Regulation's board. IBAC February Letter, supra note 6, at 5, 8. The Commission notes that the NYSE Group directors on the NYSE Regulation board will be a minority, and thus will not by themselves be able to control any decisions of the board. In addition, the non-NYSE Group directors on the NYSE Regulation board – which must be a majority of the board – will not be selected by NYSE Group or New York Stock Exchange LLC. Rather, they will be selected either by (1) the NYSE Regulation

Exchange LLC is the sole owner of NYSE Regulation and the NYSE Delegation Agreement gives New York Stock Exchange LLC authority to review, approve, or reject action taken by NYSE Regulation (other than action taken upon review of disciplinary decisions by the board of NYSE Regulation),[154] there cannot be sufficient regulatory independence with the presence of NYSE Group directors on the New York Stock Exchange LLC board.[155] The SIA and TBMA recommend that the NYSE be required to create greater structural separation by reducing or eliminating NYSE Group representation on the New York Stock Exchange LLC and NYSE Regulation boards and by permitting direct member representation on those boards.[156]

Several commenters believe that a for-profit structure is inconsistent with self-regulatory obligations. Nasdaq believes that it is fundamentally inconsistent with the mission of a for-profit

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DCRC, which is composed of member representatives, or members, through a petition process, or (2) the NYSE Regulation nominating and governance committee, which must have a majority of non-NYSE Group directors. New York Stock Exchange LLC must appoint or elect such persons as directors (unless they do not meet the independence requirements or are subject to a statutory disqualification). See supra Sections II.A.2.c. and II.A.2.d. for a more detailed description of the board nomination and election process for NYSE Regulation.

154 Although proposed New York Stock Exchange Rules 475, 476, and 476A state that the New York Stock Exchange LLC board will be able to review disciplinary decisions pursuant to those rules, New York Stock Exchange LLC has delegated such authority to NYSE Regulation pursuant to the NYSE Delegation Agreement, and has explicitly stated in such agreement that action taken by NYSE Regulation shall be final action of the exchange. Thus, New York Stock Exchange LLC will not be able to review any disciplinary action taken by NYSE Regulation. Any change to the NYSE Delegation Agreement would be required to be filed as a proposed rule change pursuant to Section 19(b) of the Act 15 U.S.C. 78f(b).

155 SIA/TBMA Letter, supra note 6, at 8-9.

156 Id. at 4. The ICI also suggests that the NYSE increase the number of NYSE Regulation board members that are not NYSE Group board members to more than a simple majority. ICI Letter, supra note 6, at 2.

See also supra notes 102 to 110 and accompanying text for a discussion of the SIA and TBMA's comments on, and the Commission's response to, the NYSE's proposal that all board members be independent.

entity for the entire regulatory apparatus to exist within the for-profit entity, given the fiduciary duty to maximize profits.[157] IBAC also emphasizes its view that the corporate fiduciary duty of directors in a for-profit entity to maximize profits is inconsistent with SRO obligations. As long as NYSE Group controls the appointment of a majority of NYSE Regulation directors, IBAC believes that its profit motive will "reign supreme,"[158] and is concerned about compromising exchange operations in favor of short term profits.[159] The SIA and TBMA also raise this issue, questioning why language requiring the directors of NYSE Group to take into consideration the effect their actions would have on the ability of the Regulated Subsidiaries to carry out their responsibilities under the Act, and the language requiring the NYSE Group directors to give due regard to the preservation of the independence of the self-regulatory function of the Regulated Subsidiaries, would carry more weight than the fiduciary obligation to maximize profits.[160]

Nasdaq believes that it is not appropriate to have all front-line member regulatory responsibilities in the overall entity that operates the trading facility.[161] Nasdaq notes that, pursuant to its exchange registration application, it has vested most of its front-line regulatory responsibilities in NASD through contract, and that NASD will no longer be affiliated with Nasdaq. Nasdaq contrasts its structure with the NYSE's proposed structure, noting that all of the regulatory responsibilities of the New York Stock Exchange LLC and the Pacific Exchange will

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157 Nasdaq February Letter, supra note 6, at 5. Nasdaq specifically mentions a concern regarding under or over regulation of members. Id.

158 IBAC February Letter, supra note 6, at 3-5.

159 Id. at 4.

160 SIA/TBMA Letter, supra note 6, at 9-10.

161 Nasdaq February Letter, supra note 6, at 5.

be vested in entities that are subject to the control of NYSE Group, a for-profit entity.[162] IBAC requests that the Commission consider spinning off NYSE Regulation as separate not-for-profit entity completely independent of NYSE Group,[163] while CalPERS recommends a model that has complete separation between the regulatory and non-regulatory functions, such as the enterprise model for the Public Company Accounting Oversight board.[164] NASD believes that implementing a hybrid model of self-regulation will eliminate inherent conflicts when a regulator operates a market.[165]

To the extent that a well-regulated market is considered by an SRO's owners to be in their commercial interests, demutualization could better align the goals of SRO owners with their statutory obligations. The NYSE believes that NYSE Group has "every incentive" to ensure robust regulatory oversight of its market, members, and listed companies because a well-regulated marketplace is essential to attracting, and retaining, listing and trading on its market.[166] To the extent that there is a concern that profit motives may override the incentive to have a well-regulated market, as detailed above in this section the NYSE has proposed an overall structure, with several specific safeguards, designed to allow the exchange's regulatory program

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162 Id. at 5.

163 IBAC February Letter, supra note 6, at 22.

164 CalPERS Letter, supra note 6, at 2. This model would require the Commission to appoint directly the members of the entity overseeing NYSE Regulation. CalPERS also recommends that, in the absence of complete separation, at a minimum the Commission and NYSE Group monitor the effectiveness of NYSE Regulation over the next 18 months and report publicly on their findings. Id. In this regard, the Commission notes that it has ongoing regulatory, examination, and enforcement programs designed to carry out its oversight obligations with respect to the exchanges and other SROs that it regulates.

165 NASD Letter, supra note 6. See also supra notes 21 to 25 and accompanying text.

166 NYSE Response to Comments, supra note 7, at 5.

to function independently from its market operations and other commercial interests. As a result, the Commission finds that the NYSE's proposal, taken together, is consistent with the Act, particularly with Section 6(b)(1),[167] which requires an exchange to be so organized and have the capacity to carry out the purposes of the Act.

D. Delegation of Authority from New York Stock Exchange LLC

As described in detail in the Notice, the NYSE Delegation Agreement provides that New York Stock Exchange LLC will delegate to NYSE Regulation the performance of regulatory functions.[168] New York Stock Exchange LLC will delegate performance of its market functions to NYSE Market pursuant to the NYSE Delegation Agreement.[169] The NYSE also proposes to add NYSE Rule 20(a), which codifies New York Stock Exchange LLC delegation to NYSE Market and NYSE Regulation to act on behalf of New York Stock Exchange LLC, pursuant to the NYSE Delegation Agreement.[170]

New York Stock Exchange LLC, however, expressly retains ultimate responsibility for the fulfillment of its statutory and self-regulatory obligations under the Act. Accordingly, New York Stock Exchange LLC will retain ultimate responsibility for such delegated responsibilities and functions, and any actions taken pursuant to delegated authority will remain subject to review, approval, or rejection by the board of directors of New York Stock Exchange LLC in accordance with procedures established by that board of directors (provided however, that action

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167 15 U.S.C. 78f(b)(1).

168 See Notice at "Delegation and Protection of SRO Functions; Services Agreement" and NYSE Delegation Agreement, II.A.

169 See Notice at "Delegation and Protection of SRO Functions; Services Agreement" and NYSE Delegation Agreement, III.A.

170 See proposed NYSE Rule 20(a).

taken upon review of disciplinary decisions by the NYSE Regulation board of directors shall be final action of the New York Stock Exchange LLC). The NYSE has filed the NYSE Delegation Plan as part of its rules.

New York Stock Exchange LLC expressly retains the authority to: (1) delegate authority to NYSE Regulation and, to the extent applicable, NYSE Market to take actions on behalf of the New York Stock Exchange LLC; (2) elect the members of the boards of directors of NYSE Market and NYSE Regulation; (3) coordinate actions of NYSE Regulation and NYSE Market as necessary; (4) resolve as appropriate any disputes between NYSE Regulation and NYSE Market; and (5) direct NYSE Regulation and NYSE Market to take action necessary to effectuate the purposes and functions of New York Stock Exchange LLC, consistent with the independence of the regulatory functions delegated to NYSE Regulation, exchange rules, policies and procedures, and the federal securities laws.[171] All other regulatory and market functions are delegated to NYSE Regulation and NYSE Market.

1. Delegation to NYSE Regulation

NYSE Regulation will have delegated authority to, among other things, determine regulatory and trading policy relating to the business of New York Stock Exchange LLC members and member organizations and trading on NYSE Market, develop and adopt necessary and appropriate rule changes, monitor the qualifications of members and member organizations, and their associated persons, administer programs for the surveillance and enforcement of trading on NYSE Market and any of its facilities, initiate disciplinary actions to assure compliance with the rules and procedures of New York Stock Exchange LLC and the federal

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171 See Notice at "Delegation and Protection of SRO Functions; Services Agreement" and NYSE Delegation Agreement, I.

securities laws, and establish and assess regulatory fees. No assets of, and no regulatory fees, fines or penalties collected by NYSE Regulation, will be distributed or otherwise used by the rest of NYSE Group.

As noted above in Section II.C., in their comment letter the SIA and TBMA express concern about the fundamental conflict between the interests of a for-profit entity and the members that it regulates, and their belief that the NYSE proposal does not provide for adequate separation of its regulatory and commercial functions.[172] To support this contention, the SIA and TBMA point, in part, to the provision of the NYSE Delegation Agreement that provides that actions taken by NYSE Regulation or NYSE Market pursuant to delegated authority remain subject to review, approval, or rejection by the board of directors of New York Stock Exchange LLC (other than action taken upon review of disciplinary decisions by the board of NYSE Regulation, which shall be final action of the New York Stock Exchange LLC).[173]

The Commission recognizes the SIA's and TBMA's concern with respect to oversight by New York Stock Exchange LLC of functions that have been delegated to NYSE Regulation. As discussed more fully above in Section II.C., the NYSE has proposed certain measures that are designed to ensure the independence of regulation from the NYSE's commercial interests. For example, NYSE Regulation will have its own compensation and nominating and governance committees, both of which must be composed of a majority of non-NYSE Group directors. In addition, New York Stock Exchange LLC will not have the right to review any disciplinary action taken by NYSE Regulation. Further, the Commission notes that any proposed rule change of New York Stock Exchange LLC is required to be filed with, or filed with and approved by,

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172 See SIA/TBMA Letter, supra note 6.

173 Id. at 8.

the Commission pursuant to Section 19(b) of the Act.[174] The Commission also notes its own oversight responsibility with respect to the regulatory obligations of New York Stock Exchange LLC and NYSE Regulation, as well as the SRO's own legal obligations.[175]

The Commission finds that New York Stock Exchange LLC's plan of delegation is consistent with the requirements of Section 6(b)(1) of the Act, which requires an exchange to be so organized and have the capacity to be able to carry out the purposes of the Act.[176] The Commission finds it is consistent with the Act for New York Stock Exchange LLC to delegate its regulatory functions, while retaining ultimate responsibility for ensuring that its exchange business is conducted in a manner consistent with the requirements of the Act.

2. Delegation to NYSE Market

NYSE Market will have delegated authority to, among others, oversee the operation of NYSE Market, develop and adopt listing rules and rules governing the issuance of Trading Licenses, and establish and assess listing, access, transaction, and market data fees.[177] The

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174 15 U.S.C. 78s(b).

175 See, e.g., 1996 21(a) Report and 2005 NYSE Administrative Cease-and-Desist Proceeding, supra note 108, and Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding The Nasdaq Stock Market, Inc., as Overseen By Its Parent, The National Association of Securities Dealers, Inc., February 9, 2005, available at the Commission's Web site (http://www.sec.gov/litigation/investreport/34-51163.htm).

176 15 U.S.C. 78f(b)(1).

177 See Notice at "Delegation and Protection of SRO Functions; Services Agreement" and NYSE Delegation Agreement, III.A. NYSE Market's responsibilities will include the operation of 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. This unit is distinguished from the Stock Watch unit within NYSE Regulation, whose functions will include review of exception reports, alerts, and investigations. One commenter questions whether it is appropriate to include the Market Watch function within NYSE

Commission finds it is consistent with the Act for New York Stock Exchange LLC to delegate its market functions, while retaining ultimate responsibility for ensuring that its exchange business is conducted in a manner consistent with the requirements of the Act.

In addition, NYSE Market will have the authority to act as a securities information processor ("SIP") for quotations and transaction information related to securities traded on NYSE Market and other trading facilities operated by NYSE Market.[178] Section 11A(b)(1) of the Act[179] provides for the registration with the Commission of a securities information processor[180] that is acting as an exclusive processor.[181] Because NYSE Market will be engaging on an exclusive basis on behalf of New York Stock Exchange LLC in collecting, processing, or preparing for distribution or publication information with respect to transactions or quotations on

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Market's responsibilities, in light of the indictment of several NYSE floor officials and related Commission cease and desist proceedings. Nasdaq February Letter, supra note 6, at 9. The NYSE notes that Market Watch's duties are primarily informational, not regulatory, in nature. NYSE Response to Comments, supra note 7, at 14. In addition, NYSE represents that Market Watch will coordinate with regulatory staff of NYSE Regulation. See Notice, supra note 5, at note 29. The Commission believes that this delegation of functions to NYSE Market is consistent with the Act.

The NYSE also represented that NYSE Market will establish the principles and policies under which trading on NYSE Market will be conducted, and those principles and policies will be codified by NYSE Regulation in the rules of New York Stock Exchange LLC. In addition, the NYSE represented that, in light of the self-regulatory responsibilities of New York Stock Exchange LLC and NYSE Market, those entities as well as NYSE Group, will be responsible for referring to NYSE Regulation, for investigation and action as appropriate, any possible rule violations that come to their attention. See Amendment No. 6.

178 See NYSE Delegation Agreement, Section III.A.3.

179 15 U.S.C. 78k-1(b)(1).

180 See Section 3(a)(22)(A) of the Act, 15 U.S.C. 78c(a)(22)(A), for the definition of a SIP. An SRO is explicitly excluded from the definition of a SIP.

181 Section 3(a)(22)(B) of the Act, 15 U.S.C. 78c(a)(22)(B) defines an exclusive processor. Rule 609 under the Act, 17 CFR 242.609, requires that the registration of a SIP be on Form SIP, 17 CFR 249.1001.

or effected or made by means of a facility of New York Stock Exchange LLC, it is an exclusive processor that will, as of the closing date of the Merger, be required to register pursuant to Section 11A(b) of the Act.[182]

Section 11A(b)(1) of the Act[183] provides that the Commission may, by rule or order, upon its own motion or upon application by a SIP, conditionally or unconditionally exempt any SIP from any provision of Section 11A of the Act[184] or the rules or regulation thereunder, if the Commission finds that such exemption is consistent with the public interest, the protection of investors, and the purposes of Section 11A of the Act,[185] including the maintenance of fair and orderly markets in securities and the removal of impediments to and perfection of the mechanism of a national market system.[186]

The Commission has determined to grant NYSE Market a temporary exemption from registration under Section 11A(b)(1) of the Act and Rule 609 thereunder for a period of thirty (30) days from the date of closing of the Merger, while an application for registration or an application for an exemption pursuant to Section 11A(b)(1) of the Act and Rule 609 thereunder is prepared.[187] The Commission also has determined to grant a conditional continuation of the

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182 15 U.S.C. 78k-1(b)(1). An SRO that is an exclusive processor is exempt from registration under Section 11A(b)(1) of the Act because it is excluded from designation as a SIP.

183 15 U.S.C. 78k-1(b)(1).

184 15 U.S.C. 78k-1.

185 Id.

186 See also Rule 609(c), 17 CFR 242.609(c).

187 See Securities Exchange Act Release No. 12079 (February 6, 1976) (order granting temporary exemption from SIP registration for Nasdaq for (1) a period of 30 days following the consummation of the sale of the Nasdaq system to NASD and the assignment of NASD's rights in such purchase to Nasdaq, a subsidiary of NASD and (2) an additional period of ninety (90) days following the day of publication of notice

30-day temporary exemption from registration of NYSE Market, conditioned upon its filing of an application for registration or application for an exemption from registration within the 30-day time period. Such continuation shall continue for a period of 90 days following the end of the 30-day period and will afford interested persons an opportunity to submit written comments concerning the application filed with the Commission.[188]

Upon closing of the Merger, NYSE Market will succeed to the exchange business of the NYSE and will be regulated as a facility of New York Stock Exchange LLC.[189] The Commission therefore finds that such temporary exemptions are consistent with the public interest, the protection of investors, and the purposes of Section 11A of the Act. The exemptions are for a limited period of time during which the Commission will have regulatory authority over NYSE Market.

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of filing of an application for registration or exemption from registration, if such application is received within the original 30 days). See also Securities Exchange Act Release Nos. 13278 (February 17, 1977) (granting Bradford National Clearing Corporation, which was to perform SIP functions for the Pacific Exchange, a 90-day temporary exemption from registration as a SIP pending Commission determination of Bradford's application for a permanent exemption, such 90-day period to begin from the consummation of the agreement calling for Bradford's assumption of the SIP services) and 27957 (April 27, 1990), 55 FR 19140 (May 8, 1990) (granting NASD a 90-day temporary exemption from registration of its subsidiary, Market Services, Inc., which was to operate NASD's PORTAL market, as a SIP pending Commission review of its application for registration filed with the Commission).

188 Publication of notice of the filing of an application for registration is required by Section 11A(b)(3) of the Act, 15 U.S.C. 78k-1(b)(3).

189 After the Merger, NYSE Market will hold all of the current assets and liabilities of the NYSE other than its registration as a national securities exchange and other than assets or liabilities relating to regulator functions. See Notice, supra note 5.

E. Regulation and Disciplinary Process

Currently, the regulatory responsibilities of the NYSE are performed within the NYSE through the NYSE regulatory group.[190] The Office of the Hearing Board and the Chief Hearing Officer are not currently within the NYSE regulatory group; instead, they report to the NYSE board of directors through its regulatory oversight committee. The heads of Corporate Audit and Regulatory Quality Review ("RQR") likewise currently report to the regulatory oversight committee with respect of RQR functions.

After the Merger, the current NYSE regulatory group will operate as NYSE Regulation, a separate not-for-profit entity. NYSE Regulation will have the same responsibilities as the NYSE regulatory group's current responsibilities, and will contract to provide certain regulatory services to the Pacific Exchange. The NYSE Regulation board of directors will perform all the functions of the current NYSE regulatory oversight committee, with the Office of the Hearing Board and the RQR reporting to the NYSE Regulation board.

The NYSE has not proposed in this filing any changes to the initial disciplinary process.[191] Initial disciplinary hearings will be held before a Hearing Panel, the members of

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190 This group is currently referred to as "NYSE Regulation" and was so referenced in the Notice. To avoid confusion with NYSE Regulation, the not-for profit entity that will be a wholly owned subsidiary of New York Stock Exchange LLC after the Merger, we are referring to the current regulatory group as "NYSE regulatory group."

191 The Commission notes that it has recently approved a rule change by the NYSE that makes several substantive changes to NYSE Rules 475 and 476. The NYSE does not intend to implement these changes, however, until April 1, 2006. See Securities Exchange Act Release No. 53124 (January 13, 2006), 71 FR 3595 (January 23, 2006). For purposes of clarity, Exhibit 5A of Amendment No. 8 reflects the changes proposed in this filing against the current operating version of NYSE Rules 475 and 476. The NYSE represents that it will file a proposed rule change to update Rules 475 and 476, as amended by this proposed rule change, to reflect the changes that will be implemented on April 1, 2006. See Amendment No. 8, supra note 9, at 7.

which will be drawn from the Hearing Board. The members of the Hearing Board will be appointed by the chairman of NYSE Regulation, subject to the approval of the board of directors of NYSE Regulation, as will a chief hearing officer and one or more other hearing officers.

The NYSE has proposed changes to its process for review of disciplinary decisions. The proposed changes to NYSE Rules 475 and 476 provide that appeals of disciplinary decisions will be to the New York Stock Exchange LLC board of directors. However, pursuant to the NYSE Delegation Agreement, New York Stock Exchange LLC has delegated such authority to the board of directors of NYSE Regulation. Action taken by the board of directors of NYSE Regulation will be final action of the New York Stock Exchange LLC.

The NYSE has proposed that the board of directors of NYSE Regulation will delegate the authority to hear disciplinary appeals to the new Committee for Review, which will be the successor committee to the current RELS Committee of the NYSE board of directors.[192] The Committee for Review will include both NYSE Regulation directors and other individuals representing member constituencies. The NYSE represented that the Committee for Review also is expected to include individuals representing investor and listed company constituencies.[193]

In addition to the division or department of NYSE Regulation that brought the charges, the respondent, or any member of the board of directors of NYSE Regulation, the proposed rules provide that any member of the Committee for Review will be authorized to call up disciplinary decisions of a Hearing Panel for review. In addition, newly proposed Executive Floor Governors, who will include at least two specialists and two floor brokers and will constitute the

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192 See proposed NYSE Regulation Bylaws, Article III, Section 5.

193 See Notice, supra note 5, at 2093.

most senior level of practitioner supervision on the trading floor,[194] will be able to call up disciplinary decisions for review.

The NYSE Regulation board of directors can elect to review decisions by the Committee for Review. Any such decision of the NYSE Regulation board of directors will be considered final action of the exchange.[195] There will be no review by the New York Stock Exchange LLC board of directors.

The Commission finds that the changes proposed to the disciplinary process are consistent with the Act, in particular Sections 6(b)(6) and 6(b)(7) of the Act,[196] in that they provide fair procedures for the disciplining of members and persons associated with members.

F. Trading Licenses; Access to NYSE Market

Following the Merger, NYSE Market will issue Trading Licenses that will entitle their holders to have physical and electronic access to the trading facilities of NYSE Market, subject to the limitations and requirements specified in the rules of the New York Stock Exchange LLC.[197] An organization may acquire and hold a Trading License only if and for so long as such organization is qualified and approved to be a member organization of New York Stock Exchange LLC. A member organization holding a Trading License may designate a natural

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194 See proposed NYSE Rule 46A. Executive Floor Governors will be appointed by the board of directors of New York Stock Exchange LLC, in consultation with the board of directors of NYSE Regulation. Executive Floor Governors shall generally have the responsibilities of the current floor representatives on the Board of Executives, including being able to call matters for review.

195 See NYSE Delegation Agreement at I and II.A.5.

196 15 U.S.C. 78f(b)(6) and 15 U.S.C. 78f(b)(7).

197 The Trading Licenses will be issued pursuant to the conditions and procedures outlined in proposed NYSE Rule 300. The NYSE also proposed a transition rule, NYSE Rule 300T, covering the initial sale of Trading Licenses.

person to effect transactions on its behalf on the floor of NYSE Market, subject to such qualification and approvals as may be required in the rules of the New York Stock Exchange LLC.

The price and number of Trading Licenses to be issued will be determined annually by means of a Dutch auction, through which NYSE Market will establish the clearing price ("Clearing Price") at which all Trading Licenses are sold.[198] For each auction, NYSE Market will determine the minimum price that a bidder will be required to pay for each Trading License ("Minimum Bid Price"), which will be no greater than 80% of the auction price at the last annual auction. Auction participants may enter either priced bids or unpriced "at the market" bids. At the end of the auction, NYSE Market will select the highest bid price that will allow it to maximize its auction revenue. The Clearing Price, however, may not be greater than the price that will result in the sale of at least 1,000 Trading Licenses.

NYSE Market will not sell in the auction more than 1,366 Trading Licenses. If the bids at the Clearing Price would bring the total number of licenses to be sold to more than 1,366, NYSE Market will first sell licenses to the unpriced "at the market" bids and higher priced bids, and then will allocate the remaining available Trading Licenses among the bids at the Clearing Price by lot. NYSE Market also may, in its discretion, sell the number of Trading Licenses determined by the Clearing Price at a price less than the Clearing Price, but not lower than the Minimum Bid Price.

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198 Trading Licenses for the following calendar year will be sold annually through an auction conducted in December. The price of a Trading License will be payable in equal monthly installments in advance over the period in which the Trading License is in effect.

If there are insufficient bids at the Minimum Bid Price (including unpriced "at the market" bids) for the purchase of at least 1,000 Trading Licenses, NYSE Market may sell the largest number of Trading Licenses that can be sold at the Minimum Bid Price, even if such number of Trading Licenses is less than 1,000. NYSE Market also may choose to conduct another auction or auctions and set a new Minimum Bid Price (which may be lower than the initial Minimum Bid Price) and NYSE Market will not be required to establish a Clearing Price that will result in the sale of at least 1,000 Trading Licenses.

In each auction, NYSE Market will limit the number of Trading Licenses that may be bid for by a single member organization to a number that is the greater of (i) 35 and (ii) 125% of the number of Trading Licenses utilized by that member organization in its business immediately prior to the auction.

Except for the Trading Licenses to be issued for the year in which the Merger occurs, each Trading License will be valid for one year. Trading Licenses will not be transferable, and may not be assigned, sublicensed, or leased, in whole or in part.[199] Trading Licenses may be transferred, however, with the prior written consent of NYSE Market, to a qualified and approved member organization that (i) is an affiliate of the Trading License holder, or (ii) continues substantially the same business of the Trading License holder without regard to the form of the transaction used to achieve such continuation (e.g., merger, sale of substantially all assets, reincorporation, reorganization or similar transaction).

During the periods between auctions, NYSE Market will make available for sale additional Trading Licenses. The price for Trading Licenses sold between auctions will be equal

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[199] Accordingly, lease-related provisions of the NYSE Constitution will not be carried over and any references to leases in the NYSE Rules will be deleted.

to the auction price of the most recent auction, plus a premium of ten percent (10%), with the total prorated to reflect the amount of time remaining in the year. NYSE Market will not issue in any one year more than 1,366 Trading Licenses.

Trading Licenses will expire at the end of the calendar year for which they are issued. However, the holder of a Trading License may terminate the license prior to the end of the calendar year by providing at least ten days' prior written notice to NYSE Market of such termination and paying a termination fee equal to one monthly installment of the Trading License Price. In addition, if a Trading License holder has ceased to be a member organization of New York Stock Exchange LLC for any reason, such holder will be deemed to have terminated its Trading License as of the date it ceased to be a member organization.

The NYSE also proposed to establish auction procedures for the issuance of Trading Licenses in the year in which the Merger occurs. Under proposed NYSE Rule 300T, the first auction will be conducted in accordance with the procedures outlined in proposed NYSE Rule 300, except that a maximum bid price ("Maximum Bid Price") also will be established. The Minimum Bid Price and Maximum Bid Price will be 80% and 120%, respectively, of the average annual lease price for leases (including renewal leases), which leases (or renewals) commenced during the six month period ending on the last business day of the last calendar month ending at least thirty days before the opening of the auction. Trading Licenses issued in such auction will expire at the end of the calendar year in which the Merger occurs.

The Commission observes that the NYSE's proposal makes certain modifications to the Dutch auction model that are designed to provide that qualified member organizations will have fair access to NYSE Market. In particular, the proposed rules restrict the number of Trading Licenses that each member organization may bid for in an auction to the greater of 35 Trading

Licenses and 125% of the Trading Licenses used by such member organization in its business immediately prior to the auction. In addition, the Dutch auction procedure for issuing Trading Licenses requires that the Minimum Bid Price be set at a price that is no greater than 80% of the prior year's auction price.

The proposal also restricts NYSE Market from selecting an auction Clearing Price greater than the price needed to sell 1,000 Trading Licenses, provided that the Clearing Price is at least the Minimum Bid Price. Moreover, the provision that allows NYSE Market to sell additional Trading Licenses at a 10% premium from the auction price, subject to the overall limitation of 1,366 outstanding Trading Licenses, will provide new member organizations, member organizations that did not bid successfully in the auction, or member organizations with a need for additional licenses with the opportunity to obtain Trading Licenses outside of the auction.

The Commission further notes that each Trading License will include the rights to electronic and physical access to the trading facilities of NYSE Market, which are substantially similar to the access rights of current NYSE seat holders and lessees. In addition, the proposal provides that the aggregate number of Trading Licenses to be issued in any one year will be limited to 1,366, a figure that is equal to the number of seats under the NYSE's current structure.

For the foregoing reasons, the Commission finds that proposed NYSE Rules 300 and 300T provide fair access to member organizations with respect to the issuance of Trading Licenses by NYSE Market and are consistent with the Act and in particular with Sections 6(b)(2) and 6(b)(5) of the Act.[200] The Commission believes it would not be consistent with the Act and in particular Section 6(b)(5), which prohibits the rules of an exchange from unfairly

[200] 15 U.S.C. 78f(b)(2) and 15 U.S.C. 78f(b)(5).

discriminating between broker-dealers, to provide information about the auction to one member that is not available to all members.

In essence, the Dutch auction mechanism for issuing Trading Licenses involves the setting of a fee by NYSE Market for member organizations seeking access to the facility of an exchange. Thus, the proposed rules governing the Dutch auction procedure also must be examined in light of the requirement of Section 6(b)(4) of the Act[201] that these rules provide for the equitable allocation of reasonable dues, fees, and charges among members and issuers and other persons using the NYSE Market. The NYSE asserts that pricing Trading Licenses through a Dutch auction will establish a reasonable price because the price is determined by the "market," that is, by member organizations that wish to obtain Trading Licenses. The NYSE also states that the Dutch auction mechanism will allow each member organization to determine the price that it is willing to pay for a Trading License, subject to the auction procedures. Moreover, the NYSE notes that the Dutch auction mechanism for issuance of Trading Licenses is not dissimilar from the manner in which access to the NYSE was traditionally priced, with supply and demand governing the price at which traditional memberships were purchased or leased.

The Commission finds that proposed NYSE Rules 300 and 300T are consistent with Section 6(b)(4) of the Act.[202] With respect to the price for Trading Licenses that will be sold

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201 15 U.S.C. 78f(b)(4).

202 15 U.S.C. 78f(b)(4). NYSE Market conducted its first auction and announced that following the Merger, it will issue 1,274 Trading Licenses at a price of $49,290 each. The Commission notes that the NYSE cannot issue Trading Licenses at the price established by such auction until the Commission approves this proposed rule change, as amended. The NYSE represented that, at that time, New York Stock Exchange LLC will file a proposed rule change under Section 19(b)(1) of the Act to amend its

between auctions, the NYSE states that the price for such Trading Licenses is reasonable because it is based on the latest actual auction price, but with a 10% premium. The NYSE asserts that this premium is necessary to encourage participation in the annual auction as a way to promote price and quantity discovery in the auction, and also to defray out-of-cycle administrative costs. In the Commission's view, the Act does not require the NYSE to charge the same fee for Trading Licenses sold between auctions as for those licenses sold in the auction. Rather, the Act requires that the rules of an exchange provide for an equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities. The Commission believes that it is reasonable for NYSE Market to impose a 10% premium for Trading Licenses that are sold between auctions as a means to encourage participation in the auction and to help defray administrative costs for issuing Trading Licenses outside of the auction.

The Commission received three comment letters on the Trading Licenses proposal.[203] The IBAC December Letter objected to the NYSE's plan to hold the initial Trading License auction on December 20, 2005.[204] IBAC argued that, while the results of the initial auction would not be effective until the approval of the proposed rule change, the exchange's holding the auction prior to the end of the comment period contravened the statutory process for proposed rule changes under Section 19(b)(1) of the Act. In Amendment No. 5, the NYSE disagreed that

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fee schedule to set forth the price at which Trading Licenses will be sold in the auction and the price at which Trading Licenses will be sold before the next auction. The NYSE also represented that New York Stock Exchange LLC will file a similar proposed rule change following each subsequent annual auction.

203 See IBAC December Letter, IBAC February Letter, and SIA/TBMA Letter, supra note 6.

204 See IBAC December Letter, supra note 6.

holding the initial auction prior to the proposal's approval would prejudice IBAC's ability to comment. The NYSE stated that provisionally conducting the initial auction would give members and others increased certainty in planning for post-Merger business and also provide the NYSE and the Commission 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 exchange.

The IBAC February Letter claimed that the proposed auction process for Trading Licenses could have a significant burden on competition, and noted that the NYSE failed to justify this burden in the proposal's Form 19b-4.[205] IBAC asserted that, the proposed rule change, along with NYSE's Hybrid Market proposal,[206] would unfairly disadvantage floor brokers and their customers. IBAC also expressed concern that in future auctions specialists and large institutional broker-dealers could bid for an increasingly higher number of licenses (up to 125% of their prior year's allotment) and at higher prices than the prior year's auction price. IBAC argued that, as a result, it could be difficult for floor brokers to purchase Trading Licenses and compete with these larger firms. IBAC recommended that each auction for Trading Licenses have both a minimum and maximum bid price set at 20% below and above the prior year's auction price, respectively; that existing holders be entitled to acquire a Trading License in the following year at a price equal to the prior year's clearing price, plus a maximum 20% premium; and that stricter bidding limits be imposed to prevent an excessive concentration of Trading Licenses by one or more firms over time.[207]

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205 See IBAC February Letter, supra note 6, at 17-19.

206 See SR-NYSE-2004-05.

207 See IBAC February Letter, supra note 6, at 22-23.

The NYSE Response to Comments disputed that the auction procedures to price and allocate Trading Licenses would create a burden on competition.[208] The NYSE noted that the IBAC February Letter suggested that most IBAC members currently lease seats on the exchange. The NYSE pointed out that the competitive concerns that the IBAC February Letter raised are similar to the competitive risks that floor brokers and other lessees currently face in the seat lease market. The NYSE noted that seat leases, like the proposed Trading Licenses, are typically one-year contracts and prices for these leases are negotiated on an annual basis. The NYSE also noted that, under its existing structure, lessees had no assurance that they could continue to lease seats or that the price of their leases would not increase to a level that would be difficult for them to pay. The NYSE noted that to the extent a member organization today expanded its number of memberships, there could be economic pressure on the finite supply of seats.[209] The NYSE further contended that, under the proposed rule change, floor brokers would have greater protection than they currently have, because there would be a limit on the number of Trading Licenses that a member organization may bid for in each auction.[210] Finally, the NYSE asserted that the exchange is not statutorily compelled to adopt measures like the ones proposed by IBAC to protect floor brokers or any other group of users from market vicissitudes.[211]

With respect to IBAC's argument that the NYSE's proposed rule change would impose burdens on competition and would unfairly discriminate against floor brokers, the Commission believes that the proposed auction procedures for pricing and allocating Trading Licenses are

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208 See NYSE Response to Comments, supra note 7, at 16-18.

209 Id. at 17.

210 Id.

211 Id.

consistent with the Act. In particular, the Commission believes that these proposed procedures will provide a fair opportunity for floor brokers to acquire Trading Licenses and therefore that such procedures are not unfairly discriminatory and will not impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Act.[212] In addition, the exchange has represented that after each auction it will file with the Commission a proposed rule change that sets forth the price for Trading Licenses to be issued in the auction and between auctions. Thus, interested persons will have the opportunity to comment annually on the fees to be charged, and their impact on the ability to compete, for Trading Licenses.

The SIA/TBMA Letter argued that the NYSE's proposal to offer Trading Licenses that provide full access to NYSE Market does not provide for fair access by smaller broker-dealers that trade debt securities.[213] The SIA/TBMA Letter noted that the NYSE has submitted to the Commission an exemptive request to permit unlisted debt securities to be traded on its Automated Bond System. The SIA/TBMA Letter contended that the proposed rule change would compel smaller debt dealers to either forego direct access to NYSE's Automated Bond System or apply for equity trading rights that they do not need. The NYSE Response to Comments expressed skepticism that small debt dealers currently are paying to own or lease NYSE memberships to access its Automated Bond System.[214] Thus, the NYSE surmised that the SIA/TBMA Letter's comments pertained to its pending exemptive application to trade unlisted debt securities on its Automated Bond System. The NYSE stated that, if NYSE Market ultimately is able to trade unlisted debt securities and, as a result, debt-only dealers are interested

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212 15 U.S.C. 78f(b)(5) and 15 U.S.C. 78f(b)(8).

213 See SIA/TBMA Letter, supra note 6, at 20.

214 See NYSE Response to Comments, supra note 7, at 18.

in direct access to the Automated Bond System, NYSE Market likely would be interested in determining how direct access can be provided with fairness to those debt dealers, NYSE Market, and other participants in the market for debt securities.[215] The NYSE noted that the need for direct access to its Automated Bond System has not been an issue for smaller debt-only broker-dealers under the its current structure and thus the Trading License proposal is not deficient with respect to fair access by these debt market participants.[216] The NYSE further stated that it may decide in the future to issue separate licenses for electronic only access or access limited to particular products. The Commission agrees with the NYSE and believes that the NYSE's proposal will continue to provide fair access to trading of securities on its market, including debt securities.

G. Listing and Allocation of NYSE Group's or an Affiliate's Securities

NYSE Group intends to list its shares of common stock for trading on New York Stock Exchange LLC. The Commission believes that such "self-listing" raises questions as to an SRO's ability to independently and effectively enforce its own and the Commission's rules against itself or an affiliated entity, and thus comply with its statutory obligations under the Act.[217] For instance, an SRO might be reluctant to vigorously monitor for compliance with its initial and continued listing rules by the securities of an affiliated issuer or its own securities, and may be tempted to allow its own securities, or the securities of an affiliate, to be listed (and continue to be listed) on the SRO's market even if the security is not in full compliance with the

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215 Id.

216 Id.

217 See Securities Exchange Act Release Nos. 51123 (February 2, 2005), 70 FR 6743 (February 8, 2005) (SR-NASD-2004-169), and 50171 (August 9, 2004), 69 FR 50427 (August 16, 2004) (SR-PCX-2004-76).

SRO's listing rules. Similar conflicts of interest could arise in which the SRO might choose to selectively enforce, or not enforce, its trading rules with respect to trading in its own stock or that of an affiliate so as to benefit itself.

In an effort to minimize any potential conflicts involving the listing of its own securities or those of an affiliate (together, "Affiliated Securities"), the NYSE has proposed that an Affiliated Security may not be approved for listing on New York Stock Exchange LLC unless NYSE Regulation finds that such security satisfies New York Stock Exchange LLC's rules for listing, and such finding is approved by the NYSE Regulation board of directors prior to such listing.[218] However, such proposed procedure will not apply to the initial listing of the common stock of NYSE Group because proposed NYSE Rule 497 will not be in effect, the Merger will not have closed, and the NYSE Regulation board of directors will not have been constituted as contemplated in proposed NYSE Rule 497 prior to the time by which the initial listing of the NYSE Group common stock must be approved. Instead, the initial listing of NYSE Group common stock will be reviewed by the regulatory staff of NYSE and approved by the Regulatory Oversight Committee of the current board of directors of NYSE, as the most logical predecessor to the NYSE Regulation board.[219] In light of these circumstances, the Commission finds that the proposed procedure for the initial listing of the NYSE Group common stock is consistent with the Act.

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218 See proposed NYSE Rule 497. In Amendment No. 8, the NYSE proposes to clarify that such approval by the NYSE Regulation board of directors must be prior to initial listing.

219 See Notice, supra note 5, at note 38 and accompanying text, and proposed NYSE Rule 497T, as included in Amendment No. 8.

To minimize any potential conflicts that could arise relating to the selective enforcement, or non-enforcement, of the listing or trading rules of New York Stock Exchange LLC with respect to continued listing of and trading in any Affiliated Security, the NYSE has proposed to prepare and send to the Commission a quarterly report summarizing NYSE Regulation's monitoring of an Affiliated Security's compliance with listing standards and its monitoring of trading in such securities.[220] The NYSE has proposed that any notification of lack of compliance with any applicable listing standard from NYSE Regulation to NYSE Group or an affiliate, and any corresponding plan of compliance, must be reported to the Commission.[221] Proposed NYSE Rule 497(d) also will require an annual audit of compliance by NYSE Group or the affiliated issuer with the listing standards by an independent accounting firm. The Commission believes that the proposed procedures for monitoring of the listing of and trading in Affiliated Securities are consistent with the Act.

In addition, the NYSE proposes to amend NYSE Rule 103B, the Allocation Policy, with respect to the allocation of NYSE Group stock to (i) give NYSE Group the right to determine the number and identity of specialist firms that will be included in the group from which it shall choose its specialist, provided the group consists of at least four specialist firms, and (ii) provide NYSE Group with the same material with respect to each specialist firm applicant as would have been reviewed by the Allocation Committee in allocating other securities. All other aspects of the policy will continue to apply. The NYSE stated in the Notice, that it expects that the independent directors of NYSE Group will select the specialist for NYSE Group common

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220 See proposed NYSE Rule 497(c).

221 See proposed NYSE Rule 497(c)(3).

stock.[222] The NYSE also stated in the Notice that it proposed this change to the Allocation Policy in recognition of the special circumstances involved in determining which of its specialist firms will be the specialist for the NYSE Group's stock. The Commission finds this proposed rule change is consistent with the Act.

H. Regulatory Funding

The NYSE has identified several different sources of revenue for its regulatory program. An exchange has the authority to assess its members to cover its costs of regulation, subject to the requirements of the Act. New York Stock Exchange LLC has delegated this authority to NYSE Regulation with respect to regulatory and certain other fees. Subject to Commission approval, NYSE Regulation will determine, assess, collect, and retain examination, access, registration, qualification, continuing education, arbitration, dispute resolution, and other regulatory fees. The NYSE has represented that NYSE Regulation expects to continue to fund its examination programs for assuring financial responsibility and compliance with sales practice rules, testing, and continuing education through fees assessed directly on member organizations.

NYSE Regulation also will receive funding independently from the markets for which it will provide regulatory services. The NYSE has represented the services agreement between NYSE Regulation and the Pacific Exchange will ensure the provision of adequate funding to NYSE Regulation to carry out the regulatory services it will provide to the Pacific Exchange. In addition, the NYSE has represented that there will be an explicit agreement among NYSE

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[222] See Notice, supra note 5, at 2094.

Group, New York Stock Exchange LLC, NYSE Market, and NYSE Regulation to provide adequate funding to NYSE Regulation.[223]

One commenter questions whether NYSE Regulation will have to generate sufficient sanctions and penalties to fund its own operations, or, alternatively, whether NYSE Group and New York Stock Exchange LLC will be willing to adequately fund NYSE Regulation's expenses without regard to the impact on NYSE Group's "bottom line."[224] This commenter does not believe that the undertaking by the NYSE that there will be an explicit agreement among NYSE Group, New York Stock Exchange LLC, NYSE Market, and NYSE Regulation to provide adequate funding for NYSE Regulation is sufficient.[225] Another commenter believes that the governing documents of NYSE Regulation should explicitly provide the sources of its funding.[226]

The Commission notes that SROs are required to enforce their own rules and the federal securities laws against their members, and that any disciplinary action taken by an SRO (including the assessment of a fine or penalty) must be done in compliance with its rules as approved by the Commission. The Commission also notes that a member has a right of appeal of a disciplinary determination by its SRO to the Commission.[227] In addition, as noted above, NYSE Regulation has been delegated the authority to raise revenue through member and

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223 See Amendment No. 6, supra note 8.

224 IBAC February Letter, supra note 6, at 5.

225 Id. at 6.

226 SIA/TBMA Letter, supra note 6, at 25.

227 Section 19(d)(2) of the Act, 15 U.S.C. 78s(d)(2).

regulatory fees.[228] The NYSE states that, as is currently the case, a large portion of NYSE Regulation's revenues will continue to be derived from member fees paid as a percentage of gross revenues.[229] The Commission does not believe that the absence of specificity in an exchange's rules regarding regulatory funding precludes the Commission from finding that the exchange is so organized and has the capacity to be able to carry out the purposes of the Act and to comply, and to enforce compliance by its members and persons associated with its members, with the provisions of the Act, the rules and regulations thereunder, and the rules of the exchange.[230] The Commission finds that the proposed funding of NYSE Regulation's regulatory responsibilities, which includes the assessment of member and other fees, as well as funding from other entities for which NYSE Regulation will be providing regulatory services, is designed to provide sufficient funding to NYSE Regulation to enable it and New York Stock Exchange LLC to carry out their responsibilities consistent with the Act.[231]

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228 New York Stock Exchange LLC will be prohibited from using any regulatory fees, fines, or penalties for commercial purposes, and NYSE Regulation may not distribute such funds to NYSE Group or any entity other than NYSE Regulation. See supra note 144 and accompanying text.

229 NYSE Response to Comments, supra note 7, at 10.

230 The issue of what further steps, if any, should be taken with respect to transparency of an exchange's regulatory revenues and expenses is part of a Commission proposal relating to SRO governance and administration, and is better addressed in the context of the larger proposal. See Securities Exchange Act Release No. 50699 (November 18, 2004), 69 FR 71126 (December 8, 2004) ("SRO Governance Proposal").

231 The NYSE represents that no provision of this proposed rule change, including any grant of authority from New York Stock Exchange LLC to NYSE Regulation to assess, collect, and retain regulatory fees, fines, or penalties, or any limitation on the use by NYSE Regulation of such regulatory monies, will prohibit NYSE Regulation from making charitable donations if its board of directors determines such donations would be consistent with its and New York Stock Exchange LLC's obligations under the Act. The NYSE also represents that, in the future, it will file with the Commission a proposed rule

I. Options Trading Rights

The Commission received a comment letter on the proposed rule change from a group of individuals who own NYSE Option Trading Rights ("OTRs") that are separate from full NYSE seat ownership ("Separated OTRs").[232] These commenters argue that they held on to their Separated OTRs, even after the NYSE exited the options business in 1997, with the expectation that their ownership of the Separated OTRs would afford them full rights to trade options under the auspices of the NYSE or its successor entity. They now argue that such ownership does, and should continue to after the Merger, give them such right.

The NYSE has not traded options since 1997, when the Commission approved the transfer of NYSE's options business to the Chicago Board Options Exchange, Incorporated ("CBOE").[233] At that time, the NYSE and CBOE put in place a program to provide certain persons that traded options on the NYSE with trading permits to trade options on CBOE. Benefits from the leasing of the CBOE options trading permits not so issued ("lease pool") were distributed to a group of approximately 92 persons that owned OTRs.[234] The CBOE trading permits and lease pool had a duration of seven years. The Commission found the 1997 proposal to be consistent with the Act, noting that there is nothing in the Act that compels the NYSE to

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change as to NYSE Regulation's use of regulatory fees, fines, and penalties. Telephone conversation between Richard P. Bernard, Executive Vice President and General Counsel, NYSE, and Elizabeth K. King, Associate Director, Division, Commission, on February 27, 2006.

232 See OTR Investors Letter, supra note 6. See also OTR Investors Letter II, supra note 6, filed in response to the NYSE Response to Comments.

233 See Securities Exchange Act Release No. 38542 (April 23, 1997), 62 FR 23521 (April 30, 1997).

234 Holders of Separated OTRs were included in this group, and were allowed to participate in the lease pool without surrendering their OTRs.

continue to trade a particular product line and the NYSE was free to terminate its options business entirely (in which case OTR holders would not have received any lease payments).[235]

It has been over eight years since the NYSE operated an options business. The Commission notes, as do the OTR investors in their comment letter, that holders of Separated OTRs do not have any membership vote and do not have ownership in the assets of the NYSE. As a result, the Commission finds it is consistent with Section 6(b)(1) of the Act[236] and the NYSE's rules for the NYSE to eliminate its rules that provide for options trading rights.

J. Market Data

One commenter raises a concern about the market data function of the NYSE being within the control of a for-profit entity.[237] This commenter believes that all market data fees should be cost-based and that market data revenue should not be used to cross-subsidize the costs of regulation, and that a for-profit entity may be motivated to engage in profit-motivated market data pricing.[238] The Commission notes that the fees charged for consolidated market data (i.e., the "top-of-book" quotations of SROs and all reported trades) are established by the joint SRO plans that govern the collection, consolidation, and dissemination of such market data, and that all such fees must be filed with the Commission pursuant to the Act. In addition, "depth-of-

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235 See Securities Exchange Act Release No. 38542 (April 23, 1997), 62 FR 23521 (April 30, 1997).

236 15 U.S.C. 78f(b)(1).

237 See SIA/TBMA Letter, supra note 6, at 19.

238 Id. The commenter believes that tying market data fees to the cost of producing the data, while keeping costs of regulation separate, will enable full and transparent funding of regulation without overcharging for market data. Id.

book" quotations can be disseminated by all SROs, as well as non-SRO entities, such as ATSs.[239] The question of what steps, if any, should be taken by the Commission to address the level and use of market data revenue, as well as transparency of regulatory revenue and expenses, is part of a larger Commission review of the self-regulatory structure of our markets, and is better addressed in the context of this larger review.[240]

III. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act[241] that the proposed rule change (SR-NYSE-2005-77), as amended, is approved, and Amendment Nos. 6 and 8 are approved on an accelerated basis.

IT IS THEREFORE FURTHER ORDERED, pursuant to Section 11A(b)(1) of the Act, that NYSE Market shall be exempt from registration as a securities information processor for a period of thirty (30) days following the date of closing of the Merger.

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239 The NYSE notes in its response to comments that each of the members of Consolidated Tape Association can compete with the NYSE (and each other) by providing its own depth-of-book data. NYSE Response to Comments, supra note 7, at 19.

240 See Concept Release Concerning Self-Regulation, supra note 26. See also SRO Governance Proposal, supra note 230.

241 15 U.S.C. 78s(b)(2).

IT IS THEREFORE FURTHER ORDERED, pursuant to Section 11A(b)(1) of the Act, that upon the filing by NYSE Market of an application for registration or an exemption from registration as a securities information processor within the 30-day period prescribed above, NYSE Market shall be exempt from registration as a securities information processor for an additional period of ninety (90) days following the end of the original 30-day period.

By the Commission (Chairman Cox and Commissioners Glassman, Atkins, Campos, and Nazareth).

Nancy M. Morris
Secretary