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Securities and Exchange Commission

17 CFR Parts 240, 242, and 249
Self-Regulatory Organizations—Various Amendments; Proposed Rule

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240, 242, and 249

[Release No. 34–50699; File No. S7–39–04]

RIN 3235–AJ33

Fair Administration and Governance of Self-Regulatory Organizations; Disclosure and Regulatory Reporting by Self-Regulatory Organizations; Recordkeeping Requirements for Self-Regulatory Organizations; Ownership and Voting Limitations for Members of Self-Regulatory Organizations; Ownership Reporting Requirements for Members of Self-Regulatory Organizations; Listing and Trading of Affiliated Securities by a Self-Regulatory Organization

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission (''Commission'') is proposing to adopt new rules and amend existing rules and forms under the Securities Exchange Act of 1934 (''Exchange Act''). The proposals pertain to the governance, administration, transparency and ownership of self-regulatory organizations (''SROs'') that are national securities exchanges or registered securities associations and the periodic reporting of information by these SROs regarding their regulatory programs. The proposals also relate to the listing and trading by SROs of their own or affiliated securities.

First, the proposals would impose new governance standards on national securities exchanges and registered securities associations by requiring a majority of the members of the exchange's or association's board of directors to be independent. In addition, key committees of the board would be required to be composed solely of independent directors. The proposals would define the term ''independent director.'' The proposals also would require exchanges and associations to establish policies and procedures to maintain a separation between their regulatory functions and their market operations and other commercial interests, and require that funds received from regulatory fines, fees, and penalties be used for regulatory purposes.

Further, the proposals would require national securities exchanges and registered securities associations to prohibit any member that is a broker or dealer from owning and voting more than 20% of the ownership interest in the exchange or the association, or a facility of the exchange or association. To supplement these ownership and voting provisions, the proposals also would require each member of an exchange or association that is a broker or dealer to file a report with the Commission when the member acquires ownership of more than 5% of any interest in the exchange or association, or any facility thereof. Also, the Commission proposes to require national securities exchanges and national securities associations to maintain their books and records in the United States. Together, these proposals are designed to strengthen the governance and administration of SROs and address the possible concentration of ownership by member firms.

In addition, the Commission proposes to amend its forms for registration as a national securities exchange or registered securities association to require that these SROs file with the Commission and publicly disclose enhanced information relating to their governance, regulatory programs, finances, ownership structure, and other matters. Further, the Commission's rules governing the procedures for filing amendments to these registration forms would be revised to require more frequent updating of the required information and the posting of the required information on the SROs' Internet Web sites. These proposals are designed to provide greater transparency to key aspects of the governance, ownership structure, and regulatory operations of national securities exchanges and registered securities associations.

The Commission also proposes to require national securities exchanges and registered securities associations to file with the Commission, in an electronic format, quarterly and annual reports on particular aspects of their regulatory programs. This proposal is intended to enhance the Commission's oversight and surveillance of exchanges and associations by requiring them to provide the Commission with detailed regulatory information on a regular basis, thereby assisting the Commission to oversee more effectively the SROs' regulatory programs and better identify any trends or issues that may arise.

Finally, the Commission proposes to impose requirements on a national securities exchange or registered securities association that chooses to list or trade its own security, the security of any trading facility, or the security of an affiliate of itself or a facility. The proposed requirements are designed to assure that these SROs are able to enforce effectively their listing standards with respect to, and supervise trading in, their own or a facility's securities, or the securities of affiliates of the SRO or a facility.

DATES: Comments should be submitted on or before January 24, 2005.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/proposed.shtml*); or
- Send an e-mail to *rule-comments@sec.gov.* Please include File Number S7–39–04 on the subject line; or
- Use the Federal eRulemaking Portal (*http://www.regulations.gov*). Follow the instructions for submitting comments.

Paper Comments

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609.

All submissions should refer to File Number S7–39–04. This file number should be included on the subject line if e-mail is used. To help us 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/proposed.shtml*). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: *SRO Governance and Disclosure:* Nancy J. Sanow, Assistant Director, at (202) 942–0796, Susie Cho, Special Counsel, at (202) 942–0748, Leah Mesfin, Special Counsel, at (202) 942–0196, Geraldine Idrizi, Attorney, at (202) 942–7317, and A. Michael Pierson, Attorney, at (202) 942–0192; *Reporting Requirements for SROs:* Nancy J. Sanow, Assistant Director, at (202) 942–0796, and Richard Holley III, Attorney, at (202) 942–8086; and *SRO Ownership and Voting Restrictions, SRO Self-Listing, and Reporting Requirements for Members:* Heather Seidel, Attorney Fellow, at (202) 942–0788, Sonia Trocchio, Special Counsel, at (202) 942–0753, David Hsu, Special Counsel, at (202) 942–0731, and Jennifer Dodd, Attorney, at (202) 824–5471; all of whom are in the Division of

Market Regulation, Securities and Exchange Commission, 450 Fifth Street NW, Washington DC 20549–1001.

SUPPLEMENTARY INFORMATION: We are proposing to add new Rules 3b–19, 6a–5, 17a–26, 17a–27, and Regulation AL under the Exchange Act; amend Rules 6a–2, 15Aa–1, and 17a–1 under the Exchange Act; redesignate Rule 15Aj–1 under the Exchange Act as Rule 15Aa–2 and amend redesignated Rule 15Aa–2; amend Form 1 under the Exchange Act; redesignate Form X–15AA–1 under the Exchange Act as Form 2 and amend redesignated Form 2; and remove Forms X–15AJ–1 and X–15AJ–2 under the Exchange Act.

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I. Background

A. Self-Regulation Under the Exchange Act

The system of regulation for our Nation's securities markets and market participants is grounded on the principle of self-regulation. Thus, the Exchange Act [1] sets forth a regulatory model that combines both industry and government responsibility, based on the notion that regulation is most effective when it is done as closely as possible to the regulated activity. Congress enhanced this framework for the regulation of securities markets and market participants since the adoption of the Exchange Act, most notably in the Securities Acts Amendments of 1975.[2] While Congress at that time again weighed the risks of permitting the securities industry to regulate itself against the burdens of attempting to assure regulation directly through the government on a wide scale,[3] it refrained from changing the underlying principle of self-regulation. Thus, although the Commission has ultimate responsibility for oversight of the U.S. securities markets and their participants, the SROs continue to have ''front-line'' responsibility for overseeing trading on their markets and their members' compliance with applicable statutory and regulatory provisions.[4]

Congress, however, gave the Commission a wide range of tools to oversee this self-regulatory system and to compel SROs to act when they fail to provide adequate protection to investors.[5] For example, the Commission is empowered to approve SRO rules [6] and to abrogate, add to, or delete from SRO rules.[7] The Commission also is authorized to review disciplinary actions taken by SROs against their members.[8] In addition, the Commission has the authority to require exchanges and associations to keep records and to file reports with the Commission.[9] All records of exchanges and associations are subject, at any time, or from time to time, to reasonable periodic, special, or other examinations by the Commission.[10] If the Commission identifies deficiencies, it will bring them to the attention of the SRO and can inspect the SRO to ascertain whether corrective action has been taken. Moreover, the Commission has the authority to impose limitations on the operations of an SRO if it finds that the SRO has violated or is unable to comply with any provisions of the Exchange Act or rules or regulations thereunder, or with any of the SRO's own rules, or has failed to enforce compliance with any such provision by its members.[11] Further, the Commission has the authority to suspend or revoke the registration of an SRO,[12] and remove from office or censure any officer or director of an SRO.[13]

As part of its duties, an SRO must conduct surveillance of trading in its markets and examine the operations of its members. In addition, an exchange or association may not be registered with the Commission unless it is so organized and has the capacity to carry out the purposes of the Exchange Act and to comply with, and enforce its members' compliance with, the federal securities laws and rules thereunder, as well as its own rules.[14] An exchange or association also may not be registered unless the rules of the exchange or association, among other things: (1) Provide for a fair representation of its members on the board of directors; [15] (2) provide for an equitable allocation of

[1] 15 U.S.C. 78a, *et seq.*

[2] Securities Acts Amendments of 1975, Pub. L. 94–29, 89 Stat. 97 (1975).

[3] S. Rep. No. 75, 94th Cong., 1st Sess. (1975) at 201.

[4] Section 3(a)(26) of the Exchange Act, 15 U.S.C. 78c(a)(26), defines a self-regulatory organization as any national securities exchange, registered securities association, or registered clearing agency, or (solely for purposes of Sections 19(b), 19(c), and 23(b) of the Exchange Act, 15 U.S.C. 78s(b), 78s(c), and 78w(b)), the Municipal Securities Rulemaking Board. The proposed rulemaking would apply only to those SROs that are national securities exchanges registered under Section 6(a) of the Exchange Act, 15 U.S.C. 78f(a), and securities associations registered under Section 15A(a) of the Exchange Act, 15 U.S.C. 78*o*–3(a).

[5] *See supra* note 2.

[6] Section 19(b)(1) of the Exchange Act, 15 U.S.C. 78s(b)(1), requires an SRO to file with the Commission copies of any proposed rule or any proposed change in, addition to, or deletion from the rules of such SRO, accompanied by a concise general statement of the basis and purpose of such proposed rule change, for Commission approval. This filing requirement is supplemented by Rule 19b–4 under the Exchange Act, 17 CFR 240.19b–4.

[7] Section 19(c) of the Exchange Act, 15 U.S.C. 78s(c), permits the Commission, by rule, to abrogate, add to, or delete from the rules of an SRO as the Commission deems necessary or appropriate to insure the fair administration of the SRO, to conform its rules to requirements of the Exchange Act and the rules and regulations thereunder applicable, or otherwise in furtherance of the purposes of the Exchange Act.

[8] Section 19(d)(2) of the Exchange Act, 15 U.S.C. 78s(d)(2), states that notice of any final disciplinary sanction, denial of membership or participation, or limitation of access to services to a person, member, or person associated with a member shall be subject to review by the appropriate regulatory agency for such member, participant, applicant, or other person. Section 3(a)(34)(E) of the Exchange Act, 15 U.S.C. 78c(a)(34)(E), states that when used with respect to a member of a national securities exchange or registered securities association, the appropriate regulatory authority is the Commission.

[9] Section 17(a)(1) of the Exchange Act, 15 U.S.C. 78q(a)(1), states that exchanges and associations, among others, are required to make, keep and furnish any records, and make and disseminate any reports, that the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act.

[10] Section 17(b) of the Exchange Act, 15 U.S.C. 78q(b), states that all records of a national securities exchange or registered securities association, among others, are subject at any time, or from time to time, to such reasonable periodic, special, or other examinations by representatives of the Commission, as the Commission deems necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act.

[11] Section 19(h)(1) of the Exchange Act, 15 U.S.C. 78s(h)(1).

[12] *Id.*

[13] Section 19(h)(4) of the Exchange Act, 15 U.S.C. 78s(h)(4).

[14] Sections 6(b)(1) and 15A(b)(2) of the Exchange Act, 15 U.S.C. 78f(b)(1) and 78*o*–3(b)(2).

[15] Sections 6(b)(3) and 15A(b)(4) of the Exchange Act, 15 U.S.C. 78f(b)(3) and 78*o*–3(b)(4).

dues, fees, and charges among its members; [16] (3) are designed to prevent fraudulent and manipulative acts and practices; [17] (4) are designed to promote just and equitable principles of trade; [18] (5) are designed to perfect the mechanism of a free and open market and a national market system; [19] (6) protect investors and the public interest; [20] and (7) provide a process for disciplining its members.[21] Accordingly, the Exchange Act makes clear that SROs are charged with an important public trust to carry out their self-regulatory responsibilities effectively and fairly, while fostering free and open markets, protecting investors, and promoting the public trust.[22]

B. Overview of Recent Developments

Recent developments have prompted the Commission to review aspects of its oversight and regulation of national securities exchanges and registered securities associations and to consider whether changes are necessary to respond to those developments.

1. Governance Concerns

In the wake of corporate scandals that threatened investor confidence in the securities markets,[23] the governance of companies listed on securities exchanges and The Nasdaq Stock Market (''Nasdaq'') became the focus of attention.[24] After allegations of improprieties by several issuers and their executives, Congress enacted the Sarbanes-Oxley Act of 2002 (''Sarbanes-Oxley Act'') [25] to improve the accuracy and reliability of corporate disclosures and the effective oversight of the financial reporting process.[26] During this period, the New York Stock Exchange, Inc. (''NYSE'') and Nasdaq each undertook a review of its own corporate governance listing standards and proposed changes to strengthen those standards.[27] The new NYSE and Nasdaq corporate governance listing rules, which were approved by the Commission in November 2003, establish a more comprehensive definition of ''independence'' for directors and require the majority of members on listed companies' boards to satisfy the new independence standard.[28] In addition, the new NYSE and Nasdaq rules include a number of provisions that mandate and facilitate independent director oversight of functions relating to corporate governance, auditing, director nominations, and compensation.[29]

In light of the governance changes proposed by the NYSE and Nasdaq for their listed issuers, in March 2003, the Commission's Chairman requested that the SROs review the adequacy of their own governance practices.[30] In his letter to each SRO, the Chairman noted that the SROs play a critical role in our securities markets as standard setters for listed companies, operators of trading markets, and front-line regulators of securities firms.[31] Further, the Chairman referred to the enhanced corporate governance listing standards proposed by the NYSE and Nasdaq as a high standard that the SROs should demand not only of listed issuers, but also of themselves.[32]

Several months later, while the NYSE was reviewing its own governance practices, the media published reports of the proposed extension of the employment agreement of its then Chairman and Chief Executive Officer (''CEO''), as well as an anticipated substantial payout of his accrued compensation. In response, the Commission's Chairman sent a letter to the Chairman of the NYSE's Compensation and Human Resources Committee and Special Governance Committee requesting information regarding the compensation of the NYSE Chairman and CEO and the decision-making processes at the NYSE that led to the pay package.[33] Shortly thereafter, the Commission's Chairman sent letters to the other SROs requesting that they provide details about the extent of public representation on their boards and key committees (including the Compensation Committee); the decision-making processes with respect to the nomination of directors, their assignment to committees, and the compensation of executives; and the SROs' past practices and current plans for public disclosure of these processes and the compensation arrangements of key executives.[34]

During this period, the NYSE announced the resignation of its Chairman and CEO and shortly thereafter named an interim Chairman. In November 2003, the NYSE filed with the Commission a proposal to amend the NYSE Constitution to implement a series of governance changes at the NYSE.[35] The proposal called for the

[16] Sections 6(b)(4) and 15A(b)(5) of the Exchange Act, 15 U.S.C. 78f(b)(4) and 78*o*–3(b)(5).

[17] Sections 6(b)(5) and 15A(b)(6) of the Exchange Act, 15 U.S.C. 78f(b)(5) and 78*o*–3(b)(6).

[18] *Id.*

[19] *Id.*

[20] *Id.*

[21] Sections 6(b)(7) and 15A(b)(7) of the Exchange Act, 15 U.S.C. 78f(b)(7) and 78*o*–(b)(7).

[22] *See* Sections 6(b)(5) and 15A(b)(6) of the Exchange Act, 15 U.S.C. 78f(b)(5) and 78*o*–3(b)(6).

[23] *See, e.g.*, John Waggoner and Thomas A. Fogarty, *Scandals Shred Investors' Faith: Because of Enron, Andersen, and Rising Gas Prices, the Public Is More Wary Than Ever of Corporate America*, USA Today, May 5, 2002, and Louis Aguilar, *Scandals Jolting Faith of Investors*, Denver Post, June 27, 2002.

[24] Nasdaq is a facility of the National Association of Securities Dealers, Inc. (''NASD''). Pursuant to proposed Rule 15Aa–3(b)(11), which would define the term ''facility'' with regard to a registered securities association, Nasdaq would continue to be a facility of the NASD.

[25] Sarbanes-Oxley Act of 2002, Pub. L. 107–204, 116 Stat. 745 (2002).

[26] H.R. Conf. Rep. No. 610, 107th Cong., 2nd Sess. (2002).

[27] *See* Securities Exchange Act Release Nos. 47672 (April 11, 2003), 68 FR 19051 (April 17, 2003) (publishing for comment File No. SR–NYSE–2002–23); 48137 (July 8, 2003), 68 FR 42152 (July 16, 2003) (publishing for comment File No. SR–NASD–2002–80); 48123 (July 2, 2003), 68 FR 41191 (July 10, 2003) (publishing for comment File No. SR–NASD–2002–77); 48124 (July 2, 2003), 68 FR 41193 (July 10, 2003) (publishing for comment File No. SR–NASD–2002–138); 48125 (July 2, 2003), 68 FR 41194 (July 10, 2003) (publishing for comment File No. SR–NASD–2002–139); and 47516 (March 17, 2003), 68 FR 14451 (March 25, 2003) (publishing for comment File No. SR–NASD–2002–141).

[28] *See* Securities Exchange Act Release No. 48745 (November 4, 2003), 68 FR 64154 (November 12, 2003) (order approving File Nos. SR–NYSE–2002–33, SR–NASD–2002–77, SR–NASD–2002–80, SR–NASD–2002–138, SR–NASD–2002–139, and SR–NASD–2002–141).

[29] *See id.*

[30] *See* Letters from William H. Donaldson, Chairman, Commission, to Salvatore F. Sodano, Chairman & CEO, American Stock Exchange LLC (''Amex''); Kenneth R. Leibler, Chairman & CEO, Boston Stock Exchange, Inc. (''BSE''); William J. Brodsky, Chairman & CEO, Chicago Board Options Exchange, Inc. (''CBOE''); David A. Herron, CEO, Chicago Stock Exchange, Inc. (''CHX''); David Colker, President & CEO, Cincinnati Stock Exchange, Inc. (''CSE''); David Krell, CEO, International Securities Exchange, Inc. (''ISE''); Philip D. DeFeo, Chairman & CEO, Pacific Exchange, Inc. (''PCX''); Meyer S. Frucher, Chairman & CEO, Philadelphia Stock Exchange, Inc. (''Phlx''); Robert R. Glauber, Chairman & CEO, NASD; Richard G. Ketchum, President & Deputy Chairman, Nasdaq; and Richard A. Grasso, Chairman & CEO, NYSE (March 26, 2003). Copies of these letters are available in the Commission's Public Reference Room under File No. S7–39–04.

[31] *See id.*

[32] *See id.*

[33] *See* Letter from William H. Donaldson, Chairman, Commission, to The Honorable H. Carl McCall, Chairman, Human Resources and Compensation Committee, Chairman, Special Committee on Governance of the NYSE, NYSE, dated September 2, 2003. A copy of this letter is available in the Commission's Public Reference Room under File No. S7–39–04.

[34] *See* Letters from William H. Donaldson, Chairman, Commission, to Salvatore F. Sodano, Chairman & CEO, Amex; Kenneth R. Leibler, Chairman & CEO, BSE; William J. Brodsky, Chairman & CEO, CBOE; Robert; David A. Herron, CEO, CHX; David Colker, President & CEO, CSE; David Krell, President & CEO, ISE; Philip D. DeFeo, Chairman & CEO, PCX; Meyer S. Frucher, Chairman & CEO, Phlx; Robert R. Glauber, Chairman & CEO, NASD; and Robert Greifeld, President & CEO, Nasdaq (September 23, 2003). Copies of these letters are available in the Commission's Public Reference Room under File No. S7–39–04.

[35] *See* Securities Exchange Act Release No. 48764 (November 7, 2003), 68 FR 64380 (November 13, 2003).

establishment of a new board of directors composed wholly of independent directors; an advisory board of executives that would be representative of the exchange's various constituencies; independent board committees with specific oversight authority for compensation, audit functions, the nominations process and regulatory matters; and an autonomous regulatory unit that would report directly to the regulatory oversight committee. The Commission approved the NYSE's governance revisions in December 2003.[36]

2. Concerns Relating to Weaknesses of SRO Regulatory Programs

In addition to the enhanced focus on SRO governance, recent Commission enforcement actions involving SROs have highlighted weaknesses in the effectiveness of certain SRO regulatory programs. In September 2003, for example, the Commission settled an administrative enforcement action against the CHX for failure to enforce its trading rules.[37] The Commission's order, among other things, included findings that the CHX's surveillance program failed adequately to detect violations by its members of the firm quote rule,[38] trading ahead prohibitions,[39] and the limit order display rule[40] from 1998 through 2001. As part of the undertakings imposed by the settlement, the CHX was required, among other things, to create a regulatory oversight committee comprised almost exclusively of individuals with no material business relationship with the exchange.[41] In addition, the CHX was required to file with the Commission various certifications by its officials confirming its ongoing compliance with its statutory obligations.

Also, recent Commission enforcement actions involving SRO members have pointed to weaknesses in the effectiveness of SROs' regulatory programs. In 2004, for example, the Commission settled enforcement actions against the seven NYSE specialist firms. The Commission found that, between 1999 and 2003, these specialist firms violated federal securities laws and NYSE rules by executing orders for their dealer accounts ahead of executable public customer orders.[42] As part of the settlement, the firms agreed to pay a total of more than $247 million in penalties and disgorgement, and agreed to implement steps to improve their compliance procedures and systems.

Moreover, the Commission's staff recently has conducted inspections of SROs that have raised questions regarding whether, in certain circumstances, SROs have governance structures that are sufficiently independent, or whether SROs have maintained regulatory programs that are sufficiently rigorous to detect, deter, and discipline for members' violations of the federal securities laws and rules and SRO rules.

Taken together, developments involving SRO governance, as well as the concerns raised by recent enforcement actions[43] and inspections involving SROs, have prompted the Commission to consider new regulatory measures with respect to SROs. The Commission therefore has determined to propose rules that would strengthen the governance of national securities exchanges and registered securities associations and the independence of their regulatory programs. Moreover, the Commission is proposing to enhance the level of information that would be publicly available about SROs, including with respect to their governance structures, finances, regulatory programs, and significant owners. Finally, the Commission believes that oversight of SROs would be enhanced, and inspections could be better targeted to problematic areas, if the Commission were to receive more extensive and frequent data about SRO regulatory programs in a systematic fashion. Therefore, the Commission is proposing a new SRO reporting rule that is intended to facilitate more effective Commission monitoring of SROs' regulatory programs. While the Commission is proposing other measures that would increase the transparency of SROs' operations, the information submitted under this proposed rule is intended to be used as part of the Commission's examination program and thus may not be publicly available.

3. Competitive Concerns

More broadly, the Commission's review of SROs also was prompted by marketplace developments and the increasingly competitive environment faced by SROs that operate trading facilities. For example, in recent years, market participants have developed a variety of alternative trading systems (''ATSs'') that furnish execution services historically provided by exchanges.[44] Under Regulation ATS,[45] ATSs may choose whether (a) to register as national securities exchanges, and thus assume the responsibilities of SROs; or (b) to register as broker-dealers under Sections 15(b) or 15C of the Exchange Act,[46] subject to certain additional reporting and conduct requirements.[47] Regulation ATS was designed to impose essential elements of market-oriented regulation on ATSs, while maintaining

[36] *See* Securities Exchange Act Release No. 48946 (December 17, 2003), 68 FR 74678 (December 24, 2003).

[37] *See In the Matter of Chicago Stock Exchange,* Securities Exchange Act Release No. 48566 (September 30, 2003) (''CHX Order'').

[38] *See* CHX Article XX, Rule 7.01; *see also* Exchange Act Rule 11Ac1–1, 17 CFR 240.11Ac1–1.

[39] *See* CHX Article XXX, Rule 2.

[40] *See* CHX Article XX, Rule 7.05; *see also* Exchange Act Rule 11Ac1–4, 15 CFR 240.11Ac1–4.

[41] The CHX's regulatory oversight committee must advise the CHX's board of governors about regulatory, compliance, and enforcement matters and assist the board in monitoring the design, implementation, and effectiveness of the CHX's compliance program. *See* CHX Order, *supra* note 37.

[42] *See In the Matter of Bear Wagner Specialists LLC,* Securities Exchange Act Release No. 49498 (March 30, 2004); *In the Matter of Fleet Specialist, Inc.,* Securities Exchange Act Release No. 49499 (March 30, 2004); *In the Matter of LaBranche & Co. LLC,* Securities Exchange Act Release No. 49500 (March 30, 2004); *In the Matter of Spear, Leeds & Kellogg Specialists LLC,* Securities Exchange Act Release No. 49501 (March 30, 2004); and In the Matter of Van der Moolen Specialists USA, LLC, Securities Exchange Act Release No. 49502 (March 30, 2004). These five firms agreed to pay a total of $241.8 million in penalties and disgorgement, and agreed to implement steps to improve their compliance procedures and systems. In July 2004, the Commission and the NYSE settled enforcement actions against two other NYSE specialist firms. *See In the Matter of SIG Specialists, Inc.,* Securities Exchange Act Release No. 50076 (July 26, 2004); and *In the Matter of Performance Specialist Group LLC,* Securities Exchange Act Release No. 50075 (July 26, 2004). These firms agreed to pay a total of $5.2 million in penalties and disgorgement, consisting of $1.7 million in civil money penalties and $3.5 million in disgorgement, and agreed to implement steps to improve their compliance procedures and systems.

[43] *See, e.g.,* CHX Order, supra note 37; *In the Matter of Certain Activities of Options Exchanges,* Securities Exchange Act Release No. 43268 (September 11, 2000) (proceeding against Amex, CBOE, PCX, and Phlx for engaging in anticompetitive activities and for failing adequately to enforce compliance with their own rules); and *In the Matter of NYSE, Inc.,* Securities Exchange Act Release No. 41574 (June 29, 1999) (proceeding against NYSE for failure to enforce compliance with federal securities laws and NYSE rules prohibiting proprietary and on-floor trading by NYSE floor broker members in violation of Section 19(g) of the Exchange Act, 15 U.S.C. 78s(g)).

[44] Alternative trading systems include electronic communications networks (''ECNs'') such as INET ATS (''INET''), a subsidiary of Instinet Group, Inc. An ECN is an electronic system that widely disseminates to third parties orders entered therein by an exchange market maker or over-the-counter (''OTC'') market maker, and permits such orders to be executed against in whole or in part. The term specifically excludes internal broker-dealer order routing systems and crossing systems, *i.e.*, systems that cross multiple orders at one or more specified times at a single price set by the ECN and do not allow orders to be crossed or executed against directly by participants outside of such times. 17 CFR 240.11Ac1–1(a)(8).

[45] *See* Regulation ATS, 17 CFR 242.300, *et seq.*

[46] 15 U.S.C. 78*o*(b) and 78*o*–5.

[47] *See* Regulation ATS, 17 CFR 242.300, *et seq.*

sufficient regulatory flexibility to foster market innovation.[48]

The highly-competitive environment of recent years also has induced alliances among particular SROs and ATSs to combine the regulatory status of the SRO with the market share of the ATS. In 2001, for example, the Commission approved a proposal by PCX to establish the Archipelago Exchange (''Arca-Ex'') as a facility of its subsidiary, PCX Equities, Inc. (''PCX Equities'').[49] In addition, several ECNs have made arrangements to execute and report trades through a particular exchange, and to share the market data revenues generated thereby.[50]

Moreover, the SROs face increased competition from foreign trading markets that operate under regulatory regimes that differ from the U.S. regulatory model. These foreign markets may not be subject to the same kind of regulatory requirements that markets operated by U.S. SROs must satisfy. For example, issuers listed on U.S. exchanges or Nasdaq generally are subject to different disclosure standards than issuers whose securities are listed and traded solely on foreign markets. These differences in the U.S. reporting regime may deter some foreign issuers from U.S. registration, with the result that their securities cannot be traded on U.S. exchanges or Nasdaq, but can be traded on foreign markets or on U.S. trading systems (such as ECNs) that are not operated by SROs.

The effect of these developments is that markets operated by SROs have faced increased competition from foreign trading markets and from electronic trading systems, such as ECNs, that have made substantial inroads into the market share of the traditional SRO markets, especially with respect to Nasdaq securities. Furthermore, historic differences in the securities traded by particular SROs are disappearing. For example, the NYSE and Amex historically dominated trading in their listed securities, and market makers dominated trading in Nasdaq stocks. Today, however, for Nasdaq stocks, automated order-driven market centers (such as Nasdaq's SuperMontage, Arca-Ex, and INET) have captured more than 50% of share volume.[51] For Amex-listed stocks (for which approximately 39% of share volume now is represented by two extremely active exchange-traded funds (''ETFs'')—the QQQ and SPDR), Amex now handles approximately 21% of the volume, with the remaining balance split among Arca-Ex, INET, and others.[52] The NYSE has retained approximately 80% of the volume in its listed stocks, but other market centers are attempting to raise the level of competition and increase their share of trading.[53] Moreover, the NYSE and Amex have sought to add automated facilities that are integrated with and complement their traditional exchange floors.[54]

The historic differences between SROs that operate options trading markets have also eroded. From 1977 until 1999, most actively traded options were traded on only one exchange. In 1989, the Commission adopted Rule 19c–5 under the Exchange Act, prohibiting exchanges from having rules that limit their ability to list any stock options class because that options class is listed on another options exchange.[55] The options exchanges, however, did not widely implement multiple listing of options until 1999. By that time, the U.S. Department of Justice (''DOJ'') and the Commission had begun to investigate the four floor-based options exchanges (Amex, CBOE, PCX, and Phlx) for engaging in anticompetitive activities—in particular, for refraining from listing options listed on another exchange—and for failing to enforce adequately compliance with their own rules.[56] In addition, during that period the ISE had filed an application with the Commission to register as a national securities exchange that would trade options.[57]

As part of their settlement with the Commission, the floor-based options exchanges were ordered to collectively spend $77 million on surveillance and enforcement. The settlement of the Commission's enforcement action and the entry of a consent decree in the DOJ case, along with the proposed entry of the ISE as a national securities exchange that intended to trade options, were the catalysts for the expansion of multiple listing of equity options. Today, virtually all actively traded equity options trade on multiple markets, a development that has enhanced competition among the options exchanges.[58] The entry of electronic options trading markets has further raised the level of competition.[59]

The recent developments outlined above have led the Commission to consider whether the increasing competitive pressures placed on SROs that operate trading facilities warrant additional measures that are designed to focus the SROs on their statutorily-mandated responsibilities as market regulators. Pursuant to the Exchange Act, SROs are charged with a public trust to implement and enforce the federal securities laws and rules, as well as their own rules with respect to their members.[60] Yet, as membership organizations, and in some cases as shareholder-owned organizations, SROs are expected to promote the economic interests of their members and their owners. In addition, SROs, as operators of trading markets, are critical to the success and viability of our capital markets. In this capacity, SROs play a key role in the price discovery process, are innovators of new products, and, through the listing mechanism, provide

[48] *See* Securities Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844 (December 22, 1998) (adopting Regulation ATS).

[49] *See* Securities Exchange Act Release No. 44983 (October 25, 2001), 66 FR 55225 (November 1, 2001) (establishing Arca-Ex as the equities trading facility of PCX Equities).

[50] For example, INET has arranged to execute and report its trades through the National Stock Exchange, Inc. (''NSX'') (formerly known as CSE).

[51] The figure is based on Nasdaq/UTP Plan market data (as of September 2004). Copies of this data are available in the Commission's Public Reference Room under File No. S7–39–04.

[52] The figure is based on Network B, CTS Activity market data (as of September 2004). Copies of this data are available in the Commission's Public Reference Room under File No. S7–39–04.

[53] The figure is based on Network A, CTS Activity market data (as of September 2004). Copies of this data are available in the Commission's Public Reference Room under File No. S7–39–04.

[54] *See* Securities Exchange Act Release Nos. 50173 (August 10, 2004), 69 FR 50407 (August 16, 2004) (notice of proposed rule change proposing improvements to NYSE's existing automatic execution facility, NYSE Direct+®) and 49921 (June 25, 2004), 69 FR 40690 (July 6, 2004) (approval of proposed rule change by Amex to enhance its Auto-Ex technology for exchange-traded funds and Nasdaq stocks traded on the exchange).

[55] *See* Securities Exchange Act Release No. 26870 (May 26, 1989), 54 FR 23963 (June 5, 1989).

[56] *See* Securities Exchange Act Release No. 43268, *supra* note 43. *See also U.S.* v. *American Stock Exchange LLC, et al.*, 2000 WL 33400154 (D.D.C. 2000).

[57] *See* Securities Exchange Act Release No. 41439 (May 24, 1999), 64 FR 29367 (June 1, 1999). The Commission approved the ISE's registration application in 2000. *See* Securities Exchange Act Release No. 42455 (February 24, 2000), 65 FR 11388 (March 2, 2000).

[58] In August 1999, 32% of equity options were traded on more than one exchange. By September 2000, that number had risen to 45%. Securities Exchange Act Release No. 43085 (July 28, 2000), 65 FR 47918 (August 4, 2000) (proposing to extend Exchange Act Rule 11Ac1–1 to options). Over the same period, the percentage of aggregate option volume traded on only one exchange fell from 60% to 15%. *Id.* According to the Options Clearing Corporation, by September 2003, 98.3% of equity options classes traded on more than one exchange. *Id.*

[59] For example, the Boston Options Exchange (''BOX''), a facility of the BSE, commenced trading in 2004. *See* Securities Exchange Act Release No. 49067 (January 14, 2004), 64 FR 2761 (January 21, 2004) (order approving the operating agreement of BOX).

[60] *See* Sections 6(b)(1) and 15A(b)(2) of the Exchange Act, 15 U.S.C. 78f(b)(1) and 78*o*–3(b)(2).

issuers with an opportunity to access capital. This business model understandably would prompt SROs to be concerned with preserving and enhancing their competitive positions. As competition increases among marketplaces and SROs actively pursue strategies to increase their market share, there is a possibility that SROs could face increasing pressure from members and owners with respect to the degree of emphasis placed on their regulatory obligations. In the Commission's view, this factor underscores the need to consider measures that foster and enhance the independence of SROs' governance, the transparency of their processes, and the effectiveness of their regulatory programs.

4. Concerns Relating to New Ownership Structures

Finally, SROs have been challenged by the recent trend to demutualize and reorganize as shareholder-owned entities.[61] SROs historically have been structured as mutual, not-for-profit organizations owned, for the most part, by members that are registered broker-dealers. In 1998, the Commission expressed the view that exchanges could be organized as for-profit entities.[62] Since that time, and especially over the past few years, a number of SROs have demutualized and explicitly separated the right to trade in their markets from the economic ownership rights in those SROs. SROs have put forth various reasons for demutualizing, but common themes are an increased ability to more quickly respond to competitive pressures and additional potential sources of capital.[63]

In addition, some SROs have trading facilities that are owned and operated by persons other than the SRO itself or its members. For example, Archipelago Holdings, Inc. (''Archipelago Holdings'') operates Arca-Ex, the equities trading facility of PCX Equities, and BOX, an options trading facility of the BSE, is operated by the Boston Options Exchange Group, LLC.[64] Demutualized SROs, and separate facilities of SROs, also may choose to become publicly traded companies. For instance, Archipelago Holdings, the parent company of Arca-Ex, recently completed an initial public offering, and ISE has filed a registration statement under the Securities Act of 1933 (''Securities Act'') with regard to its intended initial public offering.[65] In addition, Nasdaq's common stock is publicly traded in the OTC market.

The impact of demutualization is the creation of another SRO constituency—a dispersed group of public shareholders—with a natural tendency to promote business interests. To the extent that a well-regulated market is considered by an SRO's owners to be in their commercial interest, demutualization could better align the goals of SRO owners with their statutory obligations. On the other hand, it could also exacerbate the concern, discussed above, that SROs may put their commercial interests ahead of their responsibilities as regulators. The trend toward demutualization of SROs is yet another reason why the Commission is proposing regulatory changes to better assure the ability of SROs to carry out effectively their regulatory obligations.

The Commission believes that the proposals—summarized above and discussed in detail below—to enhance the governance, administration, transparency and oversight of all SROs would effectively address many of the concerns raised by the demutualization of SROs. In addition, the Commission believes that it is appropriate to consider limits on member ownership of an exchange, association or facility, and heightened procedures in the case of SRO ''self-listing.''

Finally, while the Commission believes that the proposals contained herein would significantly enhance the governance, administration, transparency, and oversight of SROs, legitimate questions remain as to whether more radical structural changes are warranted. Indeed, in addition to the proposals contained in this release, the Commission is today issuing a Concept Release that discusses in detail the strengths and weaknesses of the self-regulatory model and seeks commenters' views on a wide range of issues relating to self-regulation.[66] The Concept Release examines the attributes of the current self-regulatory system, explores additional changes that could be made to the existing system to address the weaknesses of self-regulation, and discusses other models that, if implemented, would require a more extensive restructuring—or elimination—of the current system of self-regulation.[67]

II. Fair Administration and Governance of National Securities Exchanges and Registered Securities Associations

A. Background and Need for Proposed Rules 6a–5 and 15Aa–3

As operators of trading markets, front-line regulators of securities firms, and standard-setters for listed issuers, national securities exchanges and registered securities associations are critical to the integrity of the U.S. securities markets. Recent events have highlighted, however, that the securities industry's system of self-regulation has not always worked as effectively or fairly as it should.[68] In addition, the dual roles of exchanges and associations as both market overseers and market operators, the increased competition among markets, and the growing trend of exchanges to demutualize have raised concerns about their ability and efforts to fulfill their regulatory duties vigorously and impartially.[69] As exchanges and associations continue to face these and other new challenges, the Commission is proposing to address issues of SRO governance and administration, and to explore changes that could foster robust fulfillment of SROs' self-regulatory duties.

Accordingly, the Commission is proposing new Rule 6a–5 under the

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[61] *See* Securities Exchange Act Release Nos. 45803 (April 23, 2002), 67 FR 21306 (April 30, 2002) (order approving the restructuring of ISE from a limited liability company to a corporation); 49718 (May 17, 2004), 69 FR 29611 (May 24, 2004) (order approving the demutualization of PCX); and 49098 (January 16, 2004), 69 FR 3974 (January 27, 2004) (order approving the demutualization of Phlx).

[62] *See supra* note 48 (citing to the adopting release for Regulation ATS).

[63] *See* Securities Exchange Act Release Nos. 49451 (March 19, 2004), 69 FR 16305 (March 29, 2004) (PCX stating that by ''restructuring its business as a stock corporation with business control and management vested in a Board of Directors, the entity will have greater flexibility to develop and execute strategies designed to improve its competitive position than it has under the current membership-cooperative structure'' and that it anticipates that ''by restructuring as a stock corporation, PCX management will be better able to respond quickly to competitive pressures and to make changes to its operations as market conditions warrant, without diminishing the integrity of its regulatory programs.'') and 49098, *supra* note 61 (stating that Phlx proposed to effect a demutualization for a number of reasons, including to ''expand its sources of capital and revenue; to facilitate its ability to enter into relationships with strategic or financial partners who may be crucial for the Exchange's future development, capital formation and viability; to facilitate the introduction of new products and thus potentially increase transaction volume and Exchange revenues; and to better position itself to react to new opportunities and challenges'').

[64] *See* Securities Exchange Act Release Nos. 44983, *supra* note 49 and 49067, *supra* note 59.

[65] *See* Securities Exchange Act Release No. 50170 (August 9, 2004), 69 FR 50419 (August 16, 2004) (order approving PCX rule filing relating to the Certificate of Incorporation and Bylaws of Archipelago Holdings) and ISE Registration Statement on Form S–1, File No. 333–117145.

[66] *See* Securities Exchange Act Release No. 50700 (November 18, 2004).

[67] *See id.*

[68] *See supra* Section I.B.

[69] Congress was aware of the conflicting roles faced by exchanges when it designed the regulatory scheme for U.S. securities markets. *See, e.g.*, S. Rep. No. 73–792, at 4–5 (1934); H.R. Rep. No. 73–1383, at 14–16 (1934); and S. Rep. No. 73–1455, at 80–81 (1934).

Exchange Act, which pertains to the fair administration and governance of national securities exchanges, and new Rule 15Aa–3 under the Exchange Act, which pertains to the fair administration and governance of registered securities associations.[70] The proposals would apply to exchanges and associations minimum governance standards that are commensurate with standards required of listed issuers. Among other provisions, the proposed rules would require an exchange's or association's governing board to be composed of a majority of independent directors, with key board committees to be composed solely of independent directors. The Commission believes that the proposed rules would promote a structure that would facilitate the ability of SROs to perform their responsibilities under the Exchange Act with objectivity and vigor. In the Commission's view, proposed Rules 6a–5 and 15Aa–3 would further the goals of the Exchange Act, which, among other things, requires national securities exchanges and registered securities associations to be so organized and have the capacity to carry out the purposes of the Exchange Act.[71] The Commission also believes that by mandating a governance structure that is less susceptible to competing internal interests, proposed Rules 6a–5 and 15Aa–3 would help promote investor confidence in the way in which our securities markets are administered.

The proposed governance rules also would require each exchange and association to separate its regulatory function from its market operations and other commercial interests, whether through functional or organizational separation. Although a premise underlying self-regulation is that regulation works best when it is carried out in proximity to the regulated activity, it is equally important that there be sufficient independence within the self-regulatory process to adequately check undue interference or influence from the persons or entities being regulated. In the Commission's view, the proposed rules would help insulate the regulatory activities of an exchange or association from the conflicts of interest that otherwise may arise by virtue of its market operations.

In addition, the proposed rules would require an exchange or association to establish ownership and voting limitations on the interest of its members that are brokers or dealers in the exchange, association, or a facility of the exchange or association through which the member is permitted to effect transactions. Members who trade on an exchange or through a facility of an exchange or association have traditionally had ownership interests in such exchange or facility. Recent developments, including the trend towards demutualization, have raised the concern that a member's interest could become so large as to cast doubt on whether the exchange or association could fairly and objectively exercise its self-regulatory responsibilities with respect to that member. For example, an exchange may hesitate to diligently monitor and surveil the trading conduct of a member that is a controlling shareholder of the exchange or a facility of the exchange, or to diligently enforce its rules and the federal securities laws with regard to conduct by such member that violates these provisions. The Commission believes that the proposed rules would help mitigate the conflicts of interest that could occur if a member were to control a significant stake in its regulator, and are necessary and appropriate to help ensure that an exchange or association can effectively carry out its statutory obligations under Section 6(b) or 15A(b) of the Exchange Act, respectively.[72]

Finally, the Commission believes that the proposed rules are consistent with, and should enhance, the ''fair representation'' requirements applicable to exchanges and associations. As more fully discussed below, the proposals are designed to reinforce the Exchange Act requirement that the rules of an exchange or association ''assure a 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 [or association], broker, or dealer.'' [73]

B. Description of Proposed Rules 6a–5 and 15Aa–3

1. Scope of Proposed Rules 6a–5 and 15Aa–3

Under proposed Rules 6a–5 and 15Aa–3, each national securities exchange and registered securities association, respectively, would be required to comply with, have rules that comply with, and have the capacity to carry out the purposes of, the provisions of the applicable governance rule.[74] A national securities exchange registered pursuant to Section 6(g)(1) of the Exchange Act,[75] and a limited purpose national securities association registered pursuant to Section 15A(k)(1) of the Exchange Act,[76] would not be subject to these requirements.[77] While the proposed rules would establish minimum standards for the governance and administration of an exchange or association, an exchange or association, of course, could determine to establish more rigorous standards.

Certain provisions of the proposed rules would be applied to any ''regulatory subsidiary'' of the exchange or association in the same manner as they would apply to the exchange or association.[78] The term ''regulatory subsidiary'' would be defined in proposed Rules 6a–5(b)(18) and 15Aa–3(b)(19) as any person that, directly or indirectly, is controlled by the exchange or association and that provides, whether pursuant to contract, agreement or rule, regulatory services [79] to or on behalf of the exchange or association. In recent years, several exchanges, as well as the NASD, have formed subsidiaries and have delegated, pursuant to rules approved by the Commission, to those subsidiaries certain regulatory functions historically conducted by the exchange or the NASD directly.[80] These

[70] Proposed Rules 6a–5 and 15Aa–3 are substantially similar. Rule 15Aa–3(b)(11), however, proposes to define the term ''facility'' for purposes of associations. Currently, the only securities association registered under Section 15A(a) of the Exchange Act, 15 U.S.C. 78o–3(a), is the NASD.

[71] *See* Sections 6(b)(1) and 15A(b)(2) of the Exchange Act, 15 U.S.C. 78f(b)(1) and 78o–3(b)(2).

[72] 15 U.S.C. 78f(b) and 78o–3(b).

[73] 15 U.S.C. 78f(b)(3) and 78o–3(b)(4).

[74] *See* proposed Rules 6a–5(a) and 15Aa–3(a).

[75] 15 U.S.C. 78f(g)(1).

[76] 15 U.S.C. 78o–3(k)(1).

[77] *See* proposed Rules 6a–5(s)(1) and 15Aa–3(s)(1). The Commission does not have primary responsibility for regulating exchanges registered under Section 6(g)(1) of the Exchange Act and national securities associations registered under Section 15A(k)(1) of the Exchange Act (''limited purpose national securities associations''). *See* 15 U.S.C. 78f(g)(1) and 78o–3(k)(1). This responsibility instead lies with the Commodity Futures Trading Commission (''CFTC''). For this reason, such exchanges and associations are exempt from the requirements to file with the Commission proposed rule changes, except for certain specified types of rules. Importantly, exchanges registered under Section 6(g)(1) of the Exchange Act and limited purpose national securities associations are not required to file with the Commission proposed changes to rules related to their governance, ownership, or fulfillment of their self-regulatory responsibilities. Because the Commission does not have primary responsibility for the regulation of these exchanges and associations, the Commission is proposing to exempt such exchanges and associations from proposed Rules 6a–5 and 15Aa–3.

[78] Under paragraph (a) of proposed Rules 6a–5 and 15Aa–3, paragraphs (c), (d), (e), (f), (g), (h), (i), (j), (k), (l), (m), (n), (p), and (q) of the proposed rules would apply to regulatory subsidiaries.

[79] Regulatory services are intended to cover any of those activities that generally would fall within the scope of the SRO's regulatory obligations.

[80] *See, e.g.,* Securities Exchange Act Release Nos. 42759 (May 5, 2000), 65 FR 30654 (May 12, 2000) (order approving creation of PCX Equities, a wholly-owned subsidiary of PCX) and 49065

Continued

subsidiaries remain subject to the self-regulatory authority of the SRO and the SRO ultimately retains responsibility for fulfilling the self-regulatory duties imposed on it by the Exchange Act. To account for the fact that some SROs have delegated regulatory responsibilities under specified conditions to their subsidiaries, exchanges and associations would be required to apply various provisions of the proposed rules to any such subsidiaries, but only to the extent that the subsidiary has a separate governing board and key board committees. Accordingly, this proposal recognizes that a regulatory subsidiary of an exchange or association is an integral part of the SRO, and by carrying out certain self-regulatory duties on behalf of the exchange or association, it should be subject to the same governance standards applicable to the SRO itself.[81]

Each SRO subject to Rule 6a–5 or 15Aa–3 would implement the applicable rule's requirements through rule filings with the Commission pursuant to Section 19(b) of the Exchange Act.[82] SROs are required to file any proposed change in, addition to, or deletion from its rules.[83] A ''stated policy, practice, or interpretation,'' as defined in Rule 19b–4(b)(1) under the Exchange Act,[84] is deemed a proposed rule change, and includes ''any material aspect of the operation of the facilities of the [SRO].'' [85] The Commission believes that any changes made by an SRO to its or any facility's [86] articles of incorporation, constitution, bylaws, and rules, or any instrument corresponding to the foregoing, that relate to or are made to comply with proposed Rules 6a–5 or 15Aa–3 would relate to a material aspect of the operation of the facilities of the exchange or association and therefore would be required to be filed under Section 19(b).[87]

2. Board Consisting of a Majority of Independent Directors

Rules 6a–5 and 15Aa–3 would impose a series of substantive requirements with respect to the composition of the exchange's and association's board [88] that are designed to assure the independence of the board and the fair administration and governance of the exchange or association. To this end, the Commission proposes that the board of each exchange and association be composed of a majority of independent directors.[89] This provision would further the statutory goals that an exchange and association be so organized and have the capacity to carry out the Exchange Act's purposes and to comply, and enforce compliance by members and their associated persons, with the Exchange Act and rules thereunder and the SRO's own rules.[90] We note that this proposal is consistent with accepted corporate governance ''best practices'' regarding board independence.[91] The requirement to have a majority of independent directors also comports with exchange and association rules applicable to listed companies that recently were approved by the Commission to address similar governance concerns and the conflicts of interest that can arise between a company's management and its public shareholders.[92]

The Commission's proposed approach to SRO governance is multi-faceted and multi-pronged. It combines public disclosure of important governance information with guidelines for independent board representation and reliance on totally independent board committees for oversight of critical SRO functions and responsibilities.[93] The proposed rules are designed to enhance the governance of exchanges and associations, while at the same time providing them with a measure of flexibility in determining their own governance models, so long as the minimum requirements are satisfied. SROs, of course, can elect to implement a greater proportion of independent directors.[94]

The Commission believes that requiring SRO boards to have a majority of independent directors, in combination with the other proposed requirements ''for example, the proposed requirement mandating completely independent Standing Committees (as defined below) of the board [95] ''should help address the conflicts of interest that otherwise might arise when persons with a nexus to the SRO are involved in key decisions.[96]

(January 13, 2004), 69 FR 2768 (January 20, 2004) (order approving creation of Boston Options Exchange Regulation, LLC (''BOXR''), a wholly-owned subsidiary of the BSE).

For example, NASD Regulation, Inc. is responsible for carrying out most regulatory functions otherwise within the jurisdiction of the NASD; and the NASD's subsidiary, Nasdaq, pursuant to a plan of delegation, carries out certain regulatory functions on behalf of the NASD. Nasdaq would be subject to proposed Rule 15Aa–3 on two bases: It is both a facility of an association and it is an affiliate that provides regulatory services to or on behalf of the NASD. In addition, the BSE's subsidiary, BOXR, carries out certain regulatory functions on behalf of the BSE; and PCX's subsidiary, PCX Equities, carries out certain regulatory functions on behalf of PCX.

[81] To date, the Commission has permitted an SRO to delegate its regulatory responsibilities only to a subsidiary of the SRO or to another SRO. The SRO that delegates such responsibilities, however, retains primary responsibility for ensuring compliance with the Exchange Act, and rules thereunder, and the rules of the SRO.

[82] 15 U.S.C. 78s(b).

[83] *Id.*

[84] 17 CFR 240.19b–4(b)(1).

[85] *Id.*

[86] The term ''facility'' is defined in Section 3(a)(2) of the Exchange Act and, when used with respect to an exchange, includes its premises, tangible or intangible property whether on the premises or not, any right to the use of such premises or property or any service thereof for the purpose of effecting or reporting a transaction on an exchange (including, among other things, any system of communication to or from the exchange, by ticker or otherwise, maintained by or with the consent of the exchange), and any right of the exchange to the use of any property or service. *See* 15 U.S.C. 78c(a)(2). In many cases, a facility of the exchange is within the same legal entity as the exchange itself and thus only the exchange would need to meet the proposed governance rule's requirements.

The term ''facility,'' when used with respect to an association, would be defined in new Rule 15Aa–3(b)(11) as its premises, tangible or intangible property whether on the premises or not, any right to the use of such premises or property or any service thereof for the purpose of effecting or reporting a transaction (including, among other things, any system of communication to or from the association, by ticker or otherwise, maintained by or with the consent of the association), and any right of the association to the use of any property or service. If a facility of the association is within the same legal entity as the association itself, only the association would need to meet the proposed governance rule's requirements.

[87] For instance, as discussed below in Section II.B.9., an exchange or association would be required to limit its members' interest in a facility of the exchange or association, as well as the exchange or association itself, which may involve changes to the rules of the SRO, including any of the governing documents of the exchange or association, or a facility of the exchange or association.

[88] The term ''board'' would be defined in the proposed rules as the Board of Directors or Board of Governors of the exchange or association, or any equivalent body. *See* proposed Rules 6a–5(b)(5) and 15Aa–3(b)(6).

[89] *See* proposed Rules 6a–5(c)(1) and 15Aa–3(c)(1). The term ''director'' would be defined in proposed Rules 6a–5(b)(8) and 15Aa–3(b)(9) as any member of the board.

[90] *See* Sections 6(b)(1) and 15A(b)(2) of the Exchange Act, 15 U.S.C. 78f(b)(1) and 78*o*–3(b)(2).

[91] *See, e.g.,* James H. Cheek III, *et al., Report of the American Bar Association Task Force on Corporate Responsibility* (2003) (''ABA Task Force Report''); Derek Higgs, *Review of the Role and Effectiveness of Non-Executive Directors* (2003) (''Higgs Report''); and The Business Roundtable, *Principals of Corporate Governance* (May 2002) (''Business Roundtable Report'').

[92] *See, e.g.*, Securities Exchange Act Release No. 48745, *supra* note 28; NYSE *Listed Company Manual* Section 303A.01; and NASD Rule 4350(c)(1).

[93] Because of the unique role played by the SROs and the related conflicts, and in the context of the package of proposals in this release, the Commission at this time has determined to propose a majority independent director requirement for SROs. We are soliciting comment on this proposal. *See also infra* note 191.

[94] The NYSE Constitution, for example, requires that the NYSE's board of directors be entirely independent of the management of the exchange, the membership of the exchange, and issuers of securities listed on the exchange. *See* NYSE Constitution, Article IV, Sec. 2.

[95] *See infra* Section II.B.3. for a discussion on the Standing Committees of the board.

[96] *See, e.g.*, ABA Task Force Report, *supra* note 91, at 31.

These proposals together also should increase the likelihood that exchange and association boards will act in accordance with the mandates of the Exchange Act and in the best interests not only of the SRO and its members or shareholders, but also of the investing public. The Exchange Act sets broad parameters regarding the composition of an exchange's or association's governing body.[97] The proposed rules are intended to provide greater clarity to those statutory provisions.

The exchanges, the NASD, and Nasdaq generally divide their boards between industry[98] and non-industry[99] (including public)[100] directors, with a number of exchanges requiring that at least 50% of the board be composed of public or non-industry directors.[101] The proposed governance rules' definition of independence is based largely on the current notion of a ''public'' director. Like the recently-adopted NYSE and NASD rules for listed issuers,[102] the proposed governance rules also would include specific circumstances that preclude a director from being considered an independent director.[103] The Commission believes that requiring exchanges and associations to adhere to the high standards set forth in the proposed rules should help foster a greater degree of independent decision-making by the exchanges' and associations' governing bodies. In the Commission's view, the proposed rules should promote the goals of the Exchange Act that SROs be so organized and have the capacity to carry out their purposes.[104]

a. Determination of Independence. The proposals would specify that no director may qualify as an independent director unless the board affirmatively determines that the director has no material relationship with the exchange or association.[105] The term ''material relationship'' would be defined as a relationship, whether compensatory or otherwise, that reasonably could affect the independent judgment or decision-making of the director.[106] The proposals would require the board to make this independence determination upon the director's nomination and thereafter no less frequently than annually and as often as necessary in light of the director's circumstances (*e.g.*, a job change or marriage that would disqualify the director from being considered independent).[107] The Commission believes that requiring an exchange's or association's board to make an affirmative determination of independence, and to reevaluate that decision at least annually, would increase the accountability of such board and would further the proposals' goal of requiring the board to be composed of a majority of truly independent directors.[108] The proposed rules would define the term ''independent director'' as a director who has no material relationship with the exchange or association or any affiliate of the exchange or association, any member[109] of the exchange or association or any affiliate of such member, or any issuer of securities that are listed or traded on the exchange or a facility of the exchange or association.[110] The Commission believes that the rigorous proposed definitions of ''independent director'' and ''material relationship'' should help assure that SRO boards are controlled by persons not subject to potential conflicts of interest, and thereby further the goals of Sections 6(b)(1) and 15A(b)(2) of the Exchange Act.[111]

In addition to the general criteria of no material relationship, the proposed rules would identify certain specific circumstances when a director would not be considered independent.[112] A director would not be considered independent if any of the following circumstances existed:

- The director, or an immediate family member,[113] is, or within the past three years was, employed by or otherwise has or had a material relationship with the exchange or association or any affiliate of the exchange or association;[114]
- The director is, or within the past three years was, a member or employed by or affiliated with a member or any affiliate of a member, or the director has an immediate family member that is, or within the past three years was, an executive officer of a member or any affiliate of a member;[115]
- The director, or an immediate family member, has received during any twelve month period within the past three years more than $60,000 in payments from the exchange or association, any affiliate of the exchange or association or from a member or any affiliate of a member; however, payments received in the form of compensation[116] for board or board committee services, compensation to an immediate family member who is not an executive officer of the exchange or association, any affiliate of the exchange or association or of a member or any affiliate of a member, and pension and other forms of deferred compensation for prior services, not contingent on

[97] *See* Sections 6(b) and 15A(b) of the Exchange Act, 15 U.S.C. 78f(b) and 78*o*–3(b).

[98] An ''industry'' director is generally an individual who is an officer, director or employee of a broker or dealer or an affiliate of a broker or dealer, a consultant or employee of the exchange itself, or an exchange permit holder. *See, e.g.*, NASD Bylaws, Articles I(n) and I(o) and Phlx Bylaws, Article I, Section 1–1(m).

[99] A ''non-industry'' director may be an individual who has some relationship with the SRO or the financial services industry; thus, a non-industry director could not be considered truly ''public.'' For example, officers and employees of issuers listed on the exchange are considered non-industry directors. *See, e.g.*, Phlx Bylaws, Article I, Section 1–1(t) and CHX Bylaws, Article III, Section 10(1).

[100] A ''public'' director is generally an individual who has no material business relationship with a broker or dealer or with the exchange or association. *See, e.g.*, NASD Bylaws, Articles I(ee) and I(ff); Phlx Bylaws, Article I, Section 1–1(y); and CHX Bylaws, Article III, Section 10(2).

[101] For example, the BSE's board is composed of the Chairman, the Vice-Chairman and twenty other directors, ten of whom must represent the securities industry and ten of whom must represent the public. *See* BSE Constitution, Article II, Section 1. At least 50% of the directors on PCX's board are required to be persons from the public and cannot be affiliated with a broker or dealer or employed by, or involved in any material business relationship with, PCX or its affiliates. *See* PCX Bylaws, Article III, Section 3.02(a).

[102] *See* Securities Exchange Act Release No. 48745, *supra* note 28; NYSE *Listed Company Manual* Section 303A.02(b); and NASD Rules 4350, 4200(a)(15), and IM–4200.

[103] *See* proposed Rules 6a–5(b)(12) and 15Aa–3(b)(13).

[104] *See* Sections 6(b) and 15A(b) of the Exchange Act, 15 U.S.C. 78f(b) and 78o–3(b).

[105] *See* proposed Rules 6a–5(c)(2) and 15Aa–3(c)(2).

[106] *See* proposed Rules 6a–5(b)(13) and 15Aa–3(b)(14).

[107] *See* proposed Rules 6a–5(c)(2) and 15Aa–3(c)(2).

[108] Moreover, pursuant to proposed changes to exchange and association registration forms, this determination would be required to be disclosed, thereby fostering greater transparency of the SROs' governance processes. *See* proposed revised Form 1 and proposed new Form 2, *infra* Section IV.

[109] For purposes of the proposed governance rules, the term ''member'' has the same meaning as set forth in Section 3(a)(3) of the Exchange Act, 15 U.S.C. 78c(a)(3). *See* proposed Rules 6a–5(b)(14) and 15Aa–3(b)(15).

[110] *See* proposed Rules 6a–5(b)(12) and 15Aa–3(b)(13). *See also* infra note 230 (for a definition of ''affiliate'').

[111] 15 U.S.C. 78f(b)(1) and 78*o*–3(b)(2). *See generally* Sections 6(b) and 15A(b) of the Exchange Act, 15 U.S.C. 78f(b) and 78*o*–3(b).

[112] *See* proposed Rules 6a–5(b)(12) and 15Aa–3(b)(13).

[113] The term ''immediate family member'' would be defined in the proposed rules as a person's spouse, parents, children, and siblings, whether by blood, marriage, or adoption, or anyone residing in such person's house. *See* proposed Rules 6a–5(b)(11) and 15Aa–3(b)(12).

[114] *See* proposed Rules 6a–5(b)(12)(i) and 15Aa–3(b)(13)(i).

[115] *See* proposed Rules 6a–5(b)(12)(ii) and 15Aa–3(b)(13)(ii).

[116] *See* proposed Rules 6a–5(b)(6) and 15Aa–3(b)(7) for the definition of the term ''compensation.''

continued service, would not disqualify a director as independent;[117]

• The director, or an immediate family member, is a partner in, or controlling[118] shareholder or executive officer of, any organization to which, or from which, the exchange or association or any affiliate of the exchange or association made or received payments for property or services in the current or any of the past three full fiscal years that exceed 2% of the recipient's consolidated gross revenues for that year, or $200,000, whichever is more, other than certain payments arising solely from investments in the securities of the exchange or association or any facility or affiliate of the exchange or association or payments under non-discretionary charitable contribution matching programs;[119]

• The director, or an immediate family member, is, or within the past three years was, an executive officer of an issuer of securities listed or primarily traded on the exchange or a facility of the exchange or association;[120]

• The director, or an immediate family member, is, or within the past three years was, employed as an executive officer of another entity where any of the exchange's or association's executive officers serve on that entity's compensation committee;[121]

• The director, or an immediate family member, is a current partner of the outside auditor of the exchange or association or any affiliate of the exchange or association, or was a partner or employee of the outside auditor of the exchange or association or any affiliate of the exchange or association who worked on the audit of the exchange or association or any affiliate of the exchange or association, at any time within the past three years;[122] or

• In the case of a director that is a member of the Audit Committee,[123] such director (other than in his or her capacity as a member of the Audit Committee, the board, or any other board committee), accepts, directly or indirectly, any consulting, advisory, or other compensatory fee from the exchange or association, any affiliate of the exchange or association, or a member or any affiliate of a member, other than fixed amounts of pension and other forms of deferred compensation for prior service, provided such compensation is not contingent in any way on continued service.[124]

The Commission believes that the proposed circumstances that would preclude a determination of a director's independence—in effect, concluding that a ''material relationship'' exists under certain circumstances—should better assure that a majority of an SRO's board is truly independent, and thus should promote the statutory requirement that SROs be so organized and have the capacity to carry out the Exchange Act's purposes.[125] The proposed circumstances that would preclude a director from being considered independent are similar to criteria that are contained in SRO listing standards, which recently were approved by the Commission and are designed to address similar governance concerns and the conflicts of interest that can arise between a company's management and its public shareholders.[126] For example, the three-year look-back provision[127] is a feature of NYSE, NASD, and Amex rules for listed issuers;[128] the $60,000 restriction on payments received and the 2%/$200,000 threshold for payments received or made for property or services[129] are similar to factors contained in NASD and Amex listing rules;[130] and the definition of ''immediate family member[131] is substantially the same as the definition of the term ''family member'' in the NASD's listing rules.[132] The Commission further notes that because SROs are member organizations and operate markets with listing requirements, the proposed rules would take into account specific relationships between the director and a member or listed company that could challenge the impartiality of the director.[133]

In the Commission's view, the proposed relationship tests that would preclude a determination that a director is independent strike an appropriate balance and promote the goal of providing clear standards regarding the determination of independence.[134] The Commission believes that these criteria are indicative of whether directors can reach independent decisions that affect the SRO without competing pressures or conflicts of interest. For example, the fact that a director was an executive officer of a listed issuer more than three years prior to his or her nomination to the board is unlikely to have an influence on his or her decisions as a board member. On the other hand, a director's recent employment with a member does raise such concerns and would preclude a finding that he or she is independent. The Commission believes that these specific circumstances appropriately identify those relationships, such as recent employment, a business or financial relationship, or family ties, that are likely to impair the independence of a director. Further, there are practical reasons for relying on criteria that are similar to factors currently in place at the SROs for their listed issuers, as the SROs already are experienced in

[117] *See* proposed Rules 6a–5(b)(12)(iii) and 15Aa–3(b)(13)(iii). The Commission believes that compensation received as deferred compensation for prior service should not by itself exclude a director from being considered independent. However, the director would still need to satisfy the core definition of independence contained in the proposed rules.

[118] *See* proposed Rules 6a–5(b)(7) and 15Aa–3(b)(8) for the definition of the term ''control.''

[119] *See* proposed Rules 6a–5(b)(12)(iv) and 15Aa–3(b)(13)(iv).

[120] *See* proposed Rules 6a–5(b)(12)(v) and 15Aa–3(b)(13)(v).

[121] *See* proposed Rules 6a–5(b)(12)(vi) and 15Aa–3(b)(13)(vi).

[122] *See* proposed Rules 6a–5(b)(12)(vii) and 15Aa–3(b)(13)(vii).

[123] *See infra* Section II.B.3. for a discussion of the Audit Committee.

[124] *See* proposed Rules 6a–5(b)(12)(viii) and 15Aa–3(b)(13)(viii). This requirement is commensurate with an independence requirement for non-investment company issuers contained in Rule 10A–3(b)(1)(ii) under the Exchange Act, 17 CFR 240.10A–3(b)(1)(ii), which pertains to listing standards relating to audit committees. The proposed requirement is designed to help assure that there are no fee arrangements between the exchange or association or any of its affiliates and the Audit Committee member that would impair the independence of the Audit Committee member.

[125] *See* Sections 6(b)(1) and 15A(b)(2) of the Exchange Act, 15 U.S.C. 78f(b)(1) and 78o–3(b)(2).

[126] *See, e.g.*, Securities Exchange Act Release Nos. 48745, *supra* note 28 and 48863 (December 1, 2003), 68 FR 68432 (December 8, 2003) (order approving governance standards for issuers of securities listed on Amex).

[127] *See* proposed Rules 6a–5(b)(12)(i) through (vii) and 15Aa–3(b)(13)(i) through (vii).

[128] *See* NYSE *Listed Company Manual* Section 303A.02(b); NASD Rules 4350, 4200(a)(15), and IM–4200; and Amex *Company Guide,* Part I, Section 121A.

[129] *See* proposed Rules 6a–5(b)(12)(iii) and (iv) and 15Aa–3(b)(13)(iii) and (iv).

[130] *See* NASD Rules 4350, 4200(a)(15), and IM–4200 and Amex *Company Guide,* Part I, Section 121A.

[131] *See* proposed Rules 6a–5(b)(11) and 15Aa–3(b)(12).

[132] *See* NASD Rule 4200(a)(14).

[133] For example, the proposed governance rules state that a director would not be considered independent in the circumstance where a director is, or within the past three years was, a member or employed by or affiliated with a member, or the director has an immediate family member that is, or within the past three years was, an executive officer of a member or any affiliate of a member. Similarly, a director would not be considered independent in the circumstance where a director, or an immediate family member, is or within the past three years was an executive officer of an issuer of securities listed or primarily traded on the exchange or a facility of the association. *See* proposed Rules 6a–5(b)(12)(ii) and (iv) and 15Aa–3(b)(13)(ii) and (iv).

[134] *See, e.g.*, Higgs Report, *supra* note 91, at 37 and Richard C. Breeden, *Restoring Trust: Report on Corporate Governance for the Future of MCI, Inc.* (August 2002) (''Breeden Report''), at 61.

interpreting and applying those standards. The Commission emphasizes that the absence of any of the proposed relationship tests, of course, would not necessarily result in a determination of independence, as the board must still affirmatively determine that the director has no material relationship with the SRO.

b. Independent Board Requirements. The proposed governance rules would require exchanges and associations to establish policies and procedures to require each director, on his or her own initiative and upon request of the exchange or association, to inform the exchange or association of the existence or establishment of any relationship or interest that may reasonably be considered to bear on whether such director is an independent director.[135] Exchanges and associations also would be required to establish procedures for interested persons to communicate their concerns relating to any matter within the authority or jurisdiction of a Standing Committee directly to the independent directors.[136]

The proposed governance rules also would require that at least 20% of the total number of directors be selected by members.[137] In addition, the proposed governance rules would require that at least one director be representative of issuers and at least one director be representative of investors and, in each case, such director must not be associated with a member or broker or dealer.[138] The Commission believes that these provisions are consistent with the ''fair representation'' and ''issuer and investor representation'' requirements of the Exchange Act, which are discussed below.[139]

Further, the proposed governance rules would require that when the board of an exchange or association considers any matter that is recommended by or otherwise is within the authority or jurisdiction of a Standing Committee, a majority of the directors who vote on the matter must be independent directors.[140] For example, assume an exchange has a board composed of nine independent directors and eight non-independent directors. If two independent directors do not participate in a board meeting but all the non-independent directors participate in such meeting, the matter could be voted upon only by the seven independent directors present and six of the eight non-independent directors present.[141] This proposal is intended to preserve and bolster the requirement that the majority of the board be independent, and is designed to assure that matters before the board that are within the authority or jurisdiction of the fully-independent Standing Committees are considered by and voted on by a majority of independent directors.

In addition, the proposed governance rules would require that if the exchange or association fails to comply with the requirement that the board be composed of a majority of independent directors because there is a vacancy on the board or a director ceases to be independent, the exchange or association must remedy such non-compliance by the earlier of the exchange's or association's next annual meeting or one year from the date of the occurrence of the event that caused the non-compliance.[142] This provision is consistent with the standard imposed on listed issuers and, in our view, should assure prompt remediation, yet provide exchanges and associations with a reasonable period of time, consistent with their governance procedures, to cure any failure to satisfy the majority independence requirement.

c. Fair Representation. Section 6(b)(3) of the Exchange Act requires that the rules of an exchange assure a fair representation of its members in the selection of its directors and administration of its affairs (''fair representation requirement''), and must provide that one or more directors be representative of issuers and investors and not be associated with a member of the exchange, broker or dealer (''issuer and investor representation requirements'').[143] Section 15A(b)(4) of the Exchange Act contains an identical requirement with respect to the rules of an association.[144]

Consistent with the fair representation requirement, the proposed governance rules would require that the Nominating Committee [145] administer a fair process that provides members [146] with the opportunity to select at least 20% of the total number of directors (''member candidates'').[147] This requirement is not intended to prohibit exchanges and associations from having boards composed solely of independent directors. If an exchange's or association's board is composed wholly of independent directors, the candidate or candidates selected by members would have to be independent. This ''20% standard'' for member candidates comports with previously-approved SRO rule changes that raised the issue of fair representation.[148] The Commission preliminarily believes that the proposed 20% requirement strikes a proper balance by giving members a practical voice in the governance of the exchange or association and the administration of its affairs, without jeopardizing the overall independence of the board.

An exchange or association would have some leeway in implementing the fair process for members to select board candidates. For example, the Commission believes that the exchange or association would have a fair process if it established an advisory panel of members that reports to the Nominating Committee, and that is directly responsible for nominating member candidates for the board. Another type of fair process would be for the member advisory panel to make recommendations to the Nominating Committee, with the Nominating Committee required to nominate the member candidates identified by the member advisory panel. The member candidates, of course, would be required to satisfy all relevant eligibility criteria for directors (including independence requirements, if applicable). The fair process must also ensure that the member candidates actually are provided seats on the board.

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[135] *See* proposed Rules 6a–5(c)(3) and 15Aa–3(c)(3).

[136] *See* proposed Rules 6a–5(c)(9) and 15Aa–3(c)(9).

[137] *See* proposed Rules 6a–5(c)(4) and 15Aa–3(c)(4). *See infra* Section II.B.2.c. for a discussion of the statutory ''fair representation'' requirement.

[138] *See* proposed Rules 6a–5(c)(5) and 15Aa–3(c)(5).

[139] *See infra* Section II.B.2.c.

[140] *See* proposed Rules 6a–5(c)(6) and 15Aa–3(c)(6). *See infra* Section II.B.3. for a discussion of the Standing Committees of the board.

[141] Each SRO with non-independent directors would have to establish procedures for determining which non-independent directors would vote under such circumstances, consistent with the ''fair representation'' requirements discussed below.

[142] *See* proposed Rules 6a–5(c)(8) and 15Aa–3(c)(8).

[143] 15 U.S.C. 78f(b)(3).

[144] 15 U.S.C. 78*o*–3(b)(4).

[145] *See infra* Section II.B.3. for a discussion of the fully-independent Nominating Committee.

[146] *See supra* note 109 for the definition of the term ''member.''

[147] *See* proposed Rules 6a–5(f)(3) and 15Aa–3(f)(3).

[148] *See* Securities Exchange Act Release Nos. 48946, *supra* note 36 and 49718, *supra* note 61. The Commission notes that it previously has taken the position that the fair representation requirement could be satisfied if the exchange's or association's rules provided that members constitute at least 20% of the individuals serving on the Nominating Committee. *See, e.g.*, Securities Exchange Act Release Nos. 49098 and 49718, *supra* note 61. Because the proposed governance rules would mandate that the Nominating Committee consist solely of independent directors, an exchange or association no longer would have the option of satisfying the fair representation requirement by having at least 20% member representation on its Nominating Committee. Although the Commission previously approved SRO proposals that allowed members to constitute at least 20% of the exchange's or association's Nominating Committee, the Commission now believes that the governance of exchanges and associations would be strengthened by requiring a fully independent Nominating Committee.

To further address the fair representation requirement, proposed Rules 6a–5(c)(7) and 15Aa–3(c)(7) would require exchanges and associations to adopt rules to establish a fair process for the nomination of alternative candidates by members through a petition process. This requirement would provide members with the means to nominate one or more alternative candidates representative of members. The percentage of members that is necessary to put forth such alternative member candidate or candidates would be required to be specified in the exchange's or association's rules, and could not exceed 10% of the total number of members.[149] The Commission believes that this 10% requirement strikes an appropriate balance in that it provides members a practical mechanism to put forth alternative candidates, without jeopardizing the overall integrity of the nominating process. The Nominating Committee would be required to administer the petition process established by the exchange's or association's rules.[150]

To address the issuer and investor representation requirement, the Nominating Committee would be required to nominate at least one director who is representative of issuers and at least one director who is representative of investors and who, in each case, is not associated with a member or broker or dealer.[151] This provision simply would codify in Commission rules the requirements set forth in Sections 6(b)(3) and 15A(b)(4) of the Exchange Act.[152]

The Commission notes that it recently approved the NYSE's proposal to establish a fully independent board, finding that such a board could be consistent with the Exchange Act and the fair representation and issuer and investor representation requirements.[153] As discussed above, the Commission only is proposing to require exchanges and associations to elect majority-independent boards, although an SRO may elect to impose a more rigorous requirement. The Commission believes that an exchange's or association's board could be wholly-independent based on the independence criteria contained in the proposed governance rules, provided that its rules satisfy the fair representation requirement and issuer and investor representation requirements (*i.e.*, by requiring that at least 20% of the independent directors are selected by members, that at least one independent director is representative of issuers, and at least one independent director is representative of investors).

3. Standing Committees

Recent developments have highlighted the critical role that board committees play in the governance of exchanges and associations and the importance of having key committees function independently of the pressures that otherwise could be exerted on them by management, members or other interested parties.[154] The Commission is proposing that each exchange and association, at a minimum, have the following standing committees, or their equivalent: Nominating Committee; Governance Committee; Compensation Committee; Audit Committee; and Regulatory Oversight Committee (collectively, ''Standing Committees'').[155] The proposed governance rules also would require that each Standing Committee be composed solely of independent directors.[156] The Commission preliminarily believes that the functions to be performed by these committees are important to the effective administration of an exchange or association. Moreover, these are the committees that generally are charged with overseeing the SRO's regulatory responsibilities, including the SRO's commitment of financial resources to fund those responsibilities. Thus, the Commission believes that requiring all of the members of these Standing Committees to be independent would result in a greater degree of objective decision-making with respect to the exchange's or association's core responsibilities and would further the Exchange Act's goal that SROs be so organized and have the capacity to carry out their self-regulatory obligations.[157]

The proposed governance rules would require each Standing Committee to have the authority to direct and supervise inquiries into any matter brought to its attention within the scope of its duties and to obtain advice and assistance from independent legal counsel and other advisors as it determines necessary to carry out its duties.[158] In addition, each Standing Committee, other than the Governance Committee, would be required to conduct an annual performance self-evaluation.[159] Rather than conduct an annual self-evaluation of the committee's performance, the Governance Committee would be required to conduct an annual performance evaluation of the governance of the exchange or association as a whole, including the effectiveness of the board and its committees.[160] The Commission believes that these self-evaluations should assist the exchange or association in identifying strengths and deficiencies in the governance, administration, regulatory programs,

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[149] *See* proposed Rules 6a–5(c)(7) and 15Aa–3(c)(7). SROs currently have rules that permit members to engage in a petition process to nominate candidates. For example, pursuant to Phlx rules, members representing not less than 50 votes may, by written petition, independently nominate an individual for the position of on-floor governor, and members representing not less than 75 votes may propose an entire ticket, or any portion thereof, for on-floor governor positions which are vacant. *See* Phlx Bylaws, Article III, Section 3–7. A similar process is employed at the NYSE where members may propose by written petition potential nominees for positions to be filled at elections. Any such nominee must be endorsed by not less than 40 members, and not less than 100 members may petition for an entire ticket, or any portion thereof. *See* NYSE Constitution, Article III, Section 1.

[150] *See* proposed Rules 6a–5(f)(3) and 15Aa–3(f)(3).

[151] *See* proposed Rules 6a–5(f)(4) and 15Aa–3(f)(4). For example, the Nominating and Governance Committee of the NYSE currently is required to recommend to the board at least one individual who is representative of issuers and at least one individual who is representative of investors. *See* NYSE Constitution, Article IV, Sections 2 and 12.

[152] 15 U.S.C. 78f(b)(3) and 78*o*–3(b)(4).

[153] *See* Securities Exchange Act Release No. 48946, *supra* note 36.

[154] *See supra* Section I.B.

[155] *See* proposed Rules 6a–5(b)(21) and (e)(1) and 15Aa–3(b)(22) and (e)(1). An SRO would not be precluded from allowing a single committee to carry out the functions of two Standing Committees as long as the committee consisted solely of independent directors, *e.g.*, the functions of the Nominating Committee and the Governance Committee could be carried out by a single committee. Also, to the extent that a Standing Committee of the exchange or association carries out responsibilities on behalf of a regulatory subsidiary, the regulatory subsidiary would not be required to have a Standing Committee that performs the same functions. *See* proposed Rules 6a–5(a) and 15Aa–3(a).

[156] *See* proposed Rules 6a–5(f)(1), (g)(1), (h)(1), (i)(1), and (j)(1) and 15Aa–3(f)(1), (g)(1), (h)(1), (i)(1), and (j)(1). This provision is consistent with the recommendations in the Higgs Report, ABA Task Force Report and the Breeden Report. *See* Higgs Report, *supra* note 91, at 60–61; ABA Task Force Report, *supra* note 91, at 63–67; and Breeden Report, *supra* note 134, at 103.

[157] *See* Sections 6(b)(1) and 15A(b)(2) of the Exchange Act, 15 U.S.C. 78f(b)(1) and 78*o*–3(b)(2).

[158] *See* proposed Rules 6a–5(e)(2) and 15Aa–3(e)(2). The Business Roundtable Report noted that it may be appropriate for boards and committees to seek advice from outside advisors and that board and committee access to outside advisors is an important element of corporate governance. *See* Business Roundtable Report, *supra* note 91, at 27–28.

[159] *See* proposed Rules 6a–5(f)(5), (h)(3), (i)(3) and (j)(6) and 15Aa–3(f)(5), (h)(3), (i)(3) and (j)(6). The proposed rules would require each exchange and association to provide sufficient funding and other resources, as determined by each Standing Committee, to permit the Standing Committees to fulfill their responsibilities and to retain independent legal counsel and other advisors. *See* proposed Rules 6a–5(e)(3) and 15Aa–3(e)(3).

[160] *See* proposed Rules 6a–5(g)(3) and 15Aa–3(g)(3).

and financial matters of the exchange or association.[161]

In order to function effectively, each Standing Committee would need to be clear as to its role. Accordingly, the proposed rules would require that each Standing Committee have a written charter that addresses such committee's purpose and responsibilities, which, at a minimum, must be as follows:

• Nominating Committee: to identify individuals qualified to become board members, consistent with criteria approved by the board and administer a process for the nomination of individuals to the board.[162]

• Governance Committee: to develop and recommend to the board a set of governance principles applicable to the exchange or association and to oversee the evaluation of the board and management.[163]

• Compensation Committee: to have direct responsibility to review and approve corporate goals and objectives relevant to the compensation of the executive officers of the exchange or association; evaluate the performance of the executive officers in light of those goals and objectives; and consider and approve recommendations with respect to the compensation level of the executive officers, based on this evaluation.[164]

• Audit Committee: to assist the board in oversight of the integrity of the exchange's or association's financial statements; the exchange's or association's compliance with related legal and regulatory requirements; the qualifications and independence of the exchange's or association's auditor, including direct responsibility for the hiring, firing, and compensation of the auditor, overseeing the auditor's engagement, meeting regularly in executive session with the auditor, reviewing the auditor's reports with respect to the exchange's or association's internal controls, and pre-approving all audit and non-audit services performed by the auditor; determining the budget and staffing of the exchange's or association's internal audit department; and establishing procedures for the receipt of complaints regarding accounting, internal accounting controls, or auditing matters of the exchange or association and the confidential submission by employees of the exchange or association of concerns regarding questionable accounting or auditing matters.[165]

• Regulatory Oversight Committee: to assure the adequacy and effectiveness of the exchange's or association's regulatory program; assess the exchange's or association's regulatory performance; determine the regulatory plan, programs, budget, and staffing for the regulatory functions of the exchange or association; assess the performance of, and recommend compensation and personnel actions involving, the Chief Regulatory Officer[166] and other senior regulatory personnel[167] to the Compensation Committee; monitor and review regularly with the Chief Regulatory Officer matters relating to the exchange's or association's surveillance, examination, and enforcement units; assure that the exchange's or association's disciplinary and arbitration proceedings are conducted in accordance with the exchange's or association's rules and policies and any other applicable laws or rules, including those of the Commission; prior to the exchange's or association's approval of an affiliated security[168] for listing, certify that such security meets the exchange's or association's rules for listing; and approve any reports filed with the Commission as required by proposed Regulation AL (§ 242.800).[169]

The Commission believes that the foregoing proposed responsibilities of the Standing Committees would foster the effectiveness of such committees and further the objective of good governance on the part of SROs. Exchanges and associations, of course, could elect to assign additional responsibilities to the Standing Committees, as long as they were otherwise consistent with the proposed governance rules.

In addition, any committee, subcommittee, or panel that is responsible for conducting hearings, rendering decisions, and imposing sanctions with respect to disciplinary matters would be subject to the jurisdiction of the Regulatory Oversight Committee.[170] Although the Regulatory Oversight Committee would be required to be composed solely of independent directors,[171] the Commission believes that, to satisfy the fair representation requirement, the exchange or association must provide for member participation on any committee, subcommittee, or panel that is responsible for conducting hearings, rendering decisions, and imposing sanctions with respect to member disciplinary matters.[172] In order to satisfy this requirement, the proposal would require that at least 20% of the members of any such committee, subcommittee, or panel be members of the exchange or association.[173] The Commission believes that this provision furthers the requirement of the Exchange Act that an exchange or association assure a fair representation of members in the administration of its affairs.[174] By proposing to require members to be represented on bodies that consider disciplinary matters relating to members, members would be assured input into a key aspect of SRO administration that is of critical importance to them. The Commission believes that the proposed 20% requirement would provide members with a practical voice in disciplinary matters without compromising the overall independence of the disciplinary process, which would be overseen by

[161] The ABA Task Force Report recommended periodic evaluations by the directors of the effectiveness and adequacy of meetings of the board and its committees. *See* ABA Task Force Report, *supra* note 91, at 72. The Business Roundtable Report similarly recommended that the ''performance of the full board should be evaluated annually, as should the performance of its committees,'' to allow the board to determine whether it and its committees were following the procedures necessary to function effectively. *See* Business Roundtable Report, *supra* note 91, at 28.

[162] *See* proposed Rules 6a–5(f)(2) and 15Aa–3(f)(2).

[163] *See* proposed Rules 6a–5(g)(2) and 15Aa–3(g)(2).

[164] *See* proposed Rules 6a–5(h)(2) and 15Aa–3(h)(2).

[165] *See* proposed Rules 6a–5(i)(2) and 15Aa–3(i)(2). The complaint procedures for the Audit Committee are commensurate with the complaint procedures contained in Rule 10A–3(b)(3) under the Exchange Act, 17 CFR 240.10A–3(b)(3), which pertain to audit committees of listed issuers.

[166] *See* proposed Rules 6a–5(n)(3) and 15Aa–3(n)(3), which would require exchanges and associations to appoint a Chief Regulatory Officer. *See also infra* Section II.B.8.a.

[167] ''Senior regulatory personnel'' means those individuals, including the proposed Chief Regulatory Officer, who are the senior managers of the SRO's regulatory program.

[168] The term ''affiliated security'' is proposed to be defined as any security issued by an affiliated issuer, except that it would not include any option exempt from the Securities Act pursuant to Rule 238 thereunder, 17 CFR 230.238, and any security futures product exempt from the Securities Act pursuant to Section 3(a)(14) thereof, 15 U.S.C. 77c(a)(14). *See* proposed Rules 6a–5(b)(3) and 15Aa–3(b)(3). An ''affiliated issuer'' is proposed to be defined to mean an exchange, an association, an SRO trading facility of the exchange or association, an affiliate of the exchange or association, or an affiliate of an SRO trading facility of the exchange or association. *See* proposed Rules 6a–5(b)(2) and 15Aa–3(b)(2). ''SRO trading facility'' is proposed to be defined in proposed Rules 6a–5(b)(20) and 15Aa–3(b)(21) as any facility of a national securities exchange or registered securities association, respectively, that executes orders in securities.

[169] *See* proposed Rules 6a–5(j)(2) and 15Aa–3(j)(2). *See infra* Section III. for a discussion of proposed Regulation AL.

[170] *See* proposed Rules 6a–5(j)(4) and 15Aa–3(j)(4).

[171] *See* proposed Rules 6a–5(j)(1) and 15Aa–3(j)(1).

[172] *See* proposed Rules 6a–5(j)(3) and 15Aa–3(j)(3).

[173] *See id.*

[174] *See* Sections 6(b)(3) and 15A(b)(4) of the Exchange Act, 15 U.S.C. 78f(b)(3) and 78*o*–3(b)(4).

the fully independent Regulatory Oversight Committee, or the ability of the exchange or association to carry out its obligations under the Exchange Act. The Commission notes that this 20% standard is consistent with prior SRO proposals that were approved by the Commission and that provided members with a voice in the exchange's or association's disciplinary process.[175] The Commission notes, however, that unlike previously-approved structures, the proposal would require any committee, subcommittee, or panel containing members to report to the fully-independent Regulatory Oversight Committee. This requirement would be necessary because the Regulatory Oversight Committee, which is proposed to be fully independent, is intended to be the committee responsible for oversight of regulatory matters, including disciplinary matters.

The Regulatory Oversight Committee also would be required to oversee the preparation of the exchange's or association's annual regulatory report, as required by proposed Rule 17a–26 of the Exchange Act.[176]

4. Other Committees of the Board

The proposed governance rules would permit an exchange or association to establish such other committees of the board as it determines to be appropriate; however, if such committee has the authority to act on behalf of the board, that committee would be required to be composed of a majority of independent directors.[177] For example, if the exchange or association has established an Executive Committee that is empowered to act on the board's behalf, such committee would be required to be composed of a majority of independent directors. Further, the exchange or association could not delegate to any committee not consisting solely of independent directors the authority to act on matters that otherwise are within the jurisdiction of a Standing Committee.[178]

In addition, the Commission is proposing that at least 20% of the persons serving on any committee that is not a Standing Committee and any committee, subcommittee, or panel that is subject to the jurisdiction of a Standing Committee, and that is responsible for providing advice with respect to trading rules or disciplinary rules, be members of the exchange or association.[179] The Commission believes that, consistent with the Exchange Act's fair representation requirement, members should be provided with the opportunity to formally provide input on the development of, or changes to, trading and disciplinary rules. Rulemaking in this area is a key aspect of SRO administration and can have a significant impact on members. The Commission preliminarily believes that, as in prior contexts, the 20% requirement affords members a practical voice in the formulation of rules important to them. The Commission notes that it has previously approved SRO proposed rule changes that provide members with a role in developing rules relating to trading and disciplinary matters.[180]

5. Other Requirements Applicable to Directors and Officers

The duties and responsibilities imposed by the Exchange Act on exchanges and associations make clear that these SROs are charged with an important public trust and play an integral role in, among other things, maintaining securities markets that are free from fraudulent or manipulative acts or practices and that promote just and equitable principles of trade.[181] Exchanges and associations also are charged with appropriately disciplining their members pursuant to fair procedures.[182] To further these and other statutorily-imposed requirements applicable to exchanges and associations, the proposed governance rules would require that the rules of the exchange or association prohibit a person subject to any statutory disqualification, within the meaning of Section 3(a)(39) of the Exchange Act,[183] from being a director or officer of the exchange or association.[184] The Commission believes that the integrity of the exchange or association—as well as its ability to perform its statutorily required functions—could be seriously undermined if individuals subject to these serious regulatory or legal sanctions were permitted to serve on the board or as an officer of the exchange or association.

In addition, the proposed rules would require exchanges and associations to explicitly mandate that each director, in discharging his or her responsibilities as a member of the board, reasonably consider all requirements applicable to the exchange or association under the Exchange Act.[185] Exchanges and associations, as regulated entities, have certain obligations under the Exchange Act,[186] and their directors must take these obligations into account when discharging their responsibilities. We note that directors have fiduciary obligations under state law. The Commission believes, however, that expressly requiring directors to take into account the exchange's or association's obligations under the Exchange Act should help promote greater awareness and accountability on the part of directors, thus furthering the objectives of the Exchange Act.

6. Executive Sessions of the Board

The Commission believes that independent directors must be provided with the opportunity to discuss any important matters regarding the exchange or association in a frank and open manner, free from the presence of management.[187] Therefore, the Commission proposes that the independent directors of the exchange's or association's board meet regularly in executive session.[188] The Commission, however, is not proposing a minimum frequency for the independent directors to meet regularly in executive session;

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[175] *See, e.g.*, Securities Exchange Act Release Nos. 50057 (July 22, 2004), 69 FR 45091 (July 28, 2004) (notice of filing of proposed rule change including to require that the Amex Adjudicatory Council, which has the authority to act for the Amex Board of Governors with respect to, among other things, any appeal or review of a disciplinary proceeding, be composed of three industry governors and three independent governors) and 49718, *supra* note 61 (order approving the proposed rules pertaining to the demutualization of PCX and finding that permit holders would retain a voice in the administration of the affairs of the reorganized PCX, including the rulemaking and the disciplinary process, through participation on various committees).

[176] *See* proposed Rules 6a–5(j)(5) and 15Aa–3(j)(5); proposed Rule 17a–26. *See infra* Section V. for a discussion of proposed Rule 17a–26.

[177] *See* proposed Rules 6a–5(k)(1) and 15Aa–3(k)(1).

[178] *See id.*

[179] *See* proposed Rules 6a–5(k)(2) and 15Aa–3(k)(2).

[180] *See, e.g.*, Securities Exchange Act Release No. 49718, *supra* note 61 (order approving the PCX Options Trading Permit Advisory Committee, which among other things, acts in an advisory capacity regarding rule changes related to disciplinary matters and trading rules and which must be made up entirely of options trading permit holders).

[181] *See* Sections 6(b)(5) and 15A(b)(6) of the Exchange Act, 15 U.S.C. 78f(b)(5) and 78*o*–3(b)(6).

[182] *See* Sections 6(b)(6)–(7) and 15A(b)(7)–(8) of the Exchange Act, 15 U.S.C. 78f(b)(6)–(7) and 78*o*–3(b)(7)–(8).

[183] 15 U.S.C. 78c(a)(39).

[184] *See* proposed Rules 6a–5(l)(1) and 15Aa–3(l)(1).

[185] *See* proposed Rules 6a–5(l)(2) and 15Aa–3(l)(2).

[186] *See, e.g.*, 15 U.S.C. 78f(b) and 78*o*–3(b).

[187] *See* ABA Task Force Report, *supra* note 91, at 63; Breeden Report, *supra* note 134, at 52; and Higgs Report, *supra* note 91, at 34.

[188] *See* proposed Rules 6a–5(d)(1) and 15Aa–3(d)(1). The proposed governance rules would define ''executive session'' as a meeting of independent directors of the board, without the presence of either management of the exchange or association or directors who are not independent directors. *See* proposed Rules 6a–5(b)(9) and 15Aa–3(b)(10).

rather, it is leaving this decision to the board, to be based on the facts and circumstances of the particular exchange or association.

The proposed governance rules also would require that independent directors have the authority to direct and supervise inquiries into any matter brought to their attention within the scope of their duties, and to obtain advice and assistance from independent legal counsel and other advisors, as they determine necessary to carry out their duties.[189] Accordingly, the proposed governance rules would require that the exchange or association provide sufficient funding and other resources, as determined by the independent directors, to permit the independent directors to fulfill their responsibilities and to retain independent legal counsel and other advisors.[190] The Commission believes that the proposed governance rules should provide independent directors with the ability to serve effectively, including assuring that they have adequate resources and funding to perform their duties. In addition, authorizing independent directors to utilize independent legal counsel and other advisors is important to permit them to have access to advice from independent sources before acting on significant matters affecting the exchange or association.

7. Separation of Chairman of the Board and CEO Positions

The Commission is not proposing to require that an exchange's or association's Chairman of the board be an independent director in all circumstances.[191] However, if the exchange's or association's CEO is not also the Chairman, we are proposing that the Chairman must be an independent director.[192]

The proposed rules, including the provisions related to the Chairman and CEO, are designed to foster a greater degree of independent decision-making by the governing body of an exchange or association. However, while recognizing the benefits of independence, the Commission understands that some SROs may perceive efficiencies in having one person serve as Chairman and CEO, and therefore the Commission is not proposing to prohibit this arrangement. In this regard, the Commission notes that both the NYSE and BSE currently have separate individuals serving as the Chairman and as the CEO of the exchange, although the exchanges' governing documents do not expressly require this separation.[193] Nevertheless, in the event that an exchange or association elects to have a single individual serve as Chairman and CEO, the proposed governance rules would prohibit that person—who, as the CEO, would not be ''independent''—from participating in any executive sessions of the board and from serving on the Nominating, Governance, Compensation, Audit, or Regulatory Oversight Committees.[194]

The Commission also proposes that if the Chairman and CEO were the same individual, the board would be required to designate an independent director as a ''lead director'' to preside over executive sessions of the board, and the board would be required to publicly disclose the lead director's name and a means by which interested parties may communicate with the lead director.[195] This requirement should benefit exchanges and associations by providing that an independent director would head executive sessions, and thereby encourage an open climate of decision-making.

8. Separation of Regulatory and Market Operations

There is an inherent tension between an exchange's or association's role as a regulator and as the operator of a market, and between its role as a regulator and as a membership organization.[196] The existence of a shareholder class separate from membership adds yet another constituency with interests potentially in conflict with the regulatory responsibilities of the SRO. In recent years, some exchanges, as well as the NASD, have attempted to address this tension by separating, to varying degrees, their regulatory functions from their market operations.[197]

As discussed below, the Commission is proposing to require exchanges and associations, among other things, to effectively separate their regulatory function from their market operations and other commercial interests, to use regulatory funds only to fund regulatory obligations, and to establish procedures to prevent the dissemination of regulatory information other than to persons carrying out the exchange's or association's regulations obligations.[198] The Commission believes that these requirements should allow SROs to better manage the conflicts of interest inherent in any self-regulatory structure. In addition, the Commission believes that these provisions, along with other features of the proposed governance rules, would help promote greater accountability on the part of exchanges and associations with respect to their regulatory programs and strengthen their ability to meet their statutory obligations.

a. Independence of Regulatory Program. The proposed rules would require exchanges and associations to establish policies and procedures that provide for the independence of their regulatory programs from the operation or administration of their trading facilities and other businesses.[199] Specifically, the proposals would require that the exchange's or association's regulatory program be

[189] *See* proposed Rules 6a–5(d)(2) and 15Aa–3(d)(2). *See also supra* note 158 (noting the Business Roundtable Report's support of board and committee access to outside advisors).

[190] *See* proposed Rules 6a–5(d)(3) and 15Aa–3(d)(3).

[191] The Commission seeks to mitigate the conflict between an SRO's regulatory functions on the one hand, and its business operations on the other, among other conflicts. We note in this connection that, in light of the distinct statutory scheme and historical experience relevant to mutual funds and investment advisers, and in the context of different and potentially more serious conflicts, involving activities expressly prohibited by Congress, the Commission (Commissioners Glassman and Atkins dissenting) determined to require an independent chairman. *See* Investment Company Act Release No. 26520 (July 27, 2004), 69 FR 46377 (August 2, 2004); *see also supra* note 93. In the context of SROs, the Commission may require a different regulatory response. In any event, we are soliciting comment on whether this approach is appropriate in this context.

[192] *See* proposed Rules 6a–5(m)(1) and 15Aa–3(m)(1).

[193] *See* NYSE Constitution, Article IV, Section 2 and BSE Constitution, Article II, Section 1.

[194] *See* proposed Rules 6a–5(m)(2) and (4) and 15Aa–3(m)(2) and (4).

[195] *See* proposed Rules 6a–5(m)(3) and 15Aa–3(m)(3). With regard to SROs, the Commission believes at this time that, in combination with the other proposed safeguards, a lead independent director would adequately address its concerns. We are soliciting comment on these proposals.

[196] In testimony before Congress, the Commission's Chairman identified the inherent tension between an SRO's role as a regulator and as the operator of a market, and between its role as a regulator and as a membership organization, as a possible explanation for why self-regulation has not always worked as effectively and fairly as it should. *See* Testimony of William H. Donaldson, Chairman, Commission, Concerning Improving the Governance of the NYSE, before the Senate Committee on Banking, Housing and Urban Affairs (November 20, 2003).

[197] *See supra* note 80. Although the NYSE has not separated its regulatory functions and market operations into distinct legal entities, the NYSE's Regulatory Oversight and Regulatory Budget Committee is responsible for, among other things, assuring the effectiveness, vigor, and professionalism of the NYSE's regulatory program; overseeing the NYSE's Regulation, Enforcement & Listing Standards Committee and the Regulatory Quality Review Unit; determining the NYSE's regulatory plan, budget and staffing proposals annually; and assessing the NYSE's regulatory performance and recommending compensation and personnel actions involving senior regulatory personnel to the board's Human Resources & Compensation Committee for action. *See* NYSE Constitution, Article IV, Section 12(a)(4).

[198] *See* proposed Rules 6a–5(n) and 15Aa–3(n).

[199] *See* proposed Rules 6a–5(n)(1) and 15Aa–3(n)(1).

either: (1) Structurally separated from the exchange's or association's market operations and other commercial interests, by means of separate legal entities; or (2) functionally separated within the same legal entity from the exchange's or association's market operations and other commercial interests.[200] In the Commission's view, such separation must be designed to permit the regulatory program to function independently from the market operations and other commercial interests of the exchange or association. In either case, the proposed governance rules would require that the board appoint a Chief Regulatory Officer to administer the regulatory program and that the Chief Regulatory Officer report directly to the proposed independent Regulatory Oversight Committee.[201]

The Commission believes that its proposal to require the structural or functional separation of the regulatory functions and the market operations and other commercial interests of the exchange or association, together with the creation of a fully independent Regulatory Oversight Committee and the appointment of a Chief Regulatory Officer who would administer the regulatory program and report directly to the Regulatory Oversight Committee, are designed to manage more effectively the inherent conflicts of interest in our self-regulatory system and bolster the effectiveness of exchanges' and associations' regulatory programs. By not mandating a particular structure for this separation—focusing on the ends rather than the means—the proposed rules would provide exchanges and associations with a measure of flexibility in determining how best to achieve the result of functional independence of the regulatory program.

In addition, the proposed requirement that each exchange and association appoint a Chief Regulatory Officer is designed to assure that all regulatory matters are subject to oversight by a person independent of the SRO's commercial interests. Further, the proposal to require the Chief Regulatory Officer to report directly to a committee composed solely of independent directors is intended to fortify the independence of the Chief Regulatory Officer. In the Commission's view, these requirements to enhance the independence of the regulatory function further the objectives of Sections 6(b)(1) and 15A(b)(2) of the Exchange Act,[202] which require exchanges and associations, respectively, to be so organized and have the capacity to carry out the purposes of the Exchange Act, and comply, and enforce compliance by their members, and persons associated with their members, with the Exchange Act and rules thereunder and the rules of the exchange or association.

b. Use of Regulatory Fees, Fines, and Penalties. The proposed governance rules also would require an exchange or association to direct monies collected from regulatory fees, fines or penalties (''regulatory funds'') exclusively to fund the regulatory operations and other programs of the exchange or association related to its regulatory responsibilities, and to keep such books and records as are necessary to evidence compliance with this requirement.[203] Consistent with the proposed rules, an exchange or association could not use such regulatory funds to pay dividends or make distributions to its shareholders. The scope of the categories of regulatory funds included in this requirement, as well as the limitation on use of such funds, is intended to be broad. As discussed in Section IV.C. below, regulatory fees would include all member fees, dues and assessments charged and collected by an exchange or association that are assessed for the purpose of funding the operation of the exchange's or association's regulatory program.[204] Regulatory fines or penalties also would include any revenue received from fines or penalties resulting from disciplinary or enforcement actions.

This proposed restriction on the use of regulatory funds is intended to preclude an SRO from using its authority to raise regulatory funds for the purpose of benefiting its shareholders, or for other non-regulatory purposes, such as to fund executive compensation. SROs have an obligation to be so organized and have the capacity to be able to carry out the purposes of the Exchange Act, and to enforce compliance by their members with the Exchange Act and their rules.[205] SRO rules must provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities.[206] SRO rules also must provide that their members and persons associated with their members are appropriately disciplined for violations of the Exchange Act or SRO rules.[207] SROs collect various fees, dues and assessments from their members on the basis that they need to fund a program to carry out these statutory obligations. The Commission believes that these proposed requirements to use regulatory funds only to fund regulatory activities would further advance the SROs' ability to effectively comply with these statutory requirements, by helping to ensure that an SRO's regulatory activities are properly funded and that the SRO is not abusing its regulatory authority.

c. Confidentiality of Regulatory and Trading Information. Proposed Rules 6a–5(n)(5)(i)(A) and 15Aa–3(n)(5)(i)(A) would require exchanges and associations to establish policies and procedures reasonably designed to prevent the dissemination of regulatory information[208] to any person other than those officers, directors, employees, and agents of the exchange or association directly involved in carrying out the exchange's or association's regulatory obligations under the Exchange Act. This means that an exchange's or association's policies and procedures would be required to establish that regulatory information could only be available to officers and employees that are responsible for regulatory functions, directors that are involved in regulatory functions, such as an appeal of a disciplinary matter, or agents to the extent necessary to perform the regulatory function for which they have been hired. In addition, the proposed rules would require that an exchange's or association's policies and procedures be reasonably designed to prevent the use of regulatory information for any purpose other than for carrying out the exchange's or association's regulatory obligations.[209] The Commission also is proposing that an exchange's or association's policies and procedures would have to require that its officers,

[200] *See* proposed Rules 6a–5(n)(2) and 15Aa–3(n)(2).

[201] *See* proposed Rules 6a–5(n)(3) and 15Aa–3(n)(3). To the extent that the Chief Regulatory Officer of the exchange or association performs the same responsibilities for any regulatory subsidiary, the regulatory subsidiary would not need to appoint a Chief Regulatory Officer. *See* proposed Rules 6a–5(a) and 15Aa–3(a).

[202] 15 U.S.C. 78f(b)(1) and 78*o*–3(b)(2).

[203] *See* proposed Rules 6a–5(n)(4) and 15Aa–3(n)(4).

[204] *See also* proposed Exhibit I to revised Form 1 and new Form 2.

[205] *See* 15 U.S.C. 78f(b)(1) and 78*o*–3(b)(2).

[206] *See* 15 U.S.C. 78f(b)(4) and 78*o*–3(b)(5).

[207] *See* 15 U.S.C. 78f(b)(6) and 78*o*–3(b)(7).

[208] The term ''regulatory information'' is proposed to be defined to mean any information collected by an exchange or association in the course of performing its regulatory obligations under the Exchange Act. *See* proposed Rules 6a–5(b)(17) and 15Aa–3(b)(18). Examples of such regulatory information would include, for instance, information relating to an on-going disciplinary investigation or action against a member, the amount of a fine imposed on a member, financial information, or information regarding proprietary trading systems gained in the course of examining a member.

[209] *See* proposed Rules 6a–5(n)(5)(i)(B) and 15Aa–3(n)(5)(i)(B).

directors, employees and agents agree to comply with these requirements.[210]

In addition, proposed Rules 6a–5(n)(5)(i)(c) and 15Aa–3(n)(5)(i)(c) would require exchanges and associations to have policies and procedures reasonably designed to maintain the confidentiality of information that must be submitted to the exchange or association to effect a transaction on or through the exchange, association or a facility.[211] The proposed rules would, however, allow an exchange or association to make available such information in an aggregated form, if the information is aggregated to such an extent that the recipient is unable to identify (such as by reverse engineering) any person whose data is included in the aggregate information, or if the person consents.[212] Exchanges' and associations' policies and procedures also would have to require exchange and association officers, directors, employees and agents to agree to maintain the confidentiality of this information consistent with the proposed rules.[213]

The Commission believes that the requirement that exchanges and associations keep regulatory and certain other information confidential, and not use information collected in the course of performing regulatory obligations for business or other non-regulatory purposes would help to assure an independent and effective regulatory function and is implicit in the exchange's or association's responsibilities under the Exchange Act.[214] As competitive pressures on SROs increase, however, and the tensions between their regulatory obligations and commercial interests increase, the Commission believes that an explicit prohibition on this conduct may be necessary and appropriate.

9. Member Voting and Ownership Limitations

As discussed above in Section II.A., to further the ability of an exchange or association to effectively carry out its statutory obligations under Sections 6(b) and 15A(b) of the Exchange Act,[215] the Commission is proposing to require an exchange or association to limit the ability of its members that are brokers or dealers to own or vote a significant interest in the exchange, association or any separate facility.[216]

Several exchanges that have converted to shareholder-owned structures have limited the ability of any person, including their members, to directly or indirectly own or vote more than a certain percentage of the interest in the exchange.[217] Similar limits have been approved for separate SRO facilities.[218] The Commission approved these limits on a case-by-case basis under the rule filing process of Section 19(b) of the Exchange Act and Rule 19b–4 thereunder.[219]

For example, in the case of the public offering of Archipelago Holdings (the parent company of Arca-Ex, the equities trading facility of PCX Equities), the Commission approved a PCX rule prohibiting any person and its related persons from directly or indirectly owning more than 40% and voting more than 20% of the securities of Archipelago Holdings.[220] If a person wanted to exceed these limits, the rules require PCX to file a proposed rule change with the Commission and the Commission would need to approve such action. Similarly, in connection with the demutualizations of Phlx and PCX, the Commission approved a comparable prohibition under the exchanges' rules on any person and its related persons directly or indirectly owning more than 40% or voting more than 20% of the applicable securities without first receiving Commission approval of a proposed rule change.[221] In each of these three instances, the limitations applied not only to members,[222] but to any person owning securities of the applicable SRO or a facility.[223]

By proposing to require SROs only to limit the ownership and voting of their members, the Commission today is proposing a less restrictive approach than the rules adopted by the exchanges discussed above. The proposal is designed only to address the specific conflict of interest that could exist if a member were to own a significant interest in the exchange or association of which it was a member or a facility through which the member is permitted to effect transactions, by requiring an exchange or association to impose ownership and voting limits on members that are brokers or dealers.[224] The Commission believes that the conflict with respect to members creates a risk that a member could use its controlling interest in its regulator to influence the regulatory process to its benefit. Accordingly, because of the risk presented by the prospect of member control of its regulator, and the significant incentives for a member to attempt to exercise undue influence in such a case, the Commission is proposing to require an SRO to impose ownership and voting restrictions on members that are brokers or dealers.

The Commission recognizes that there is also the potential for any person that controls an exchange or association or facility of an exchange or association to direct its operation so as to cause the SRO to neglect its regulatory obligations under the Exchange Act. In light of the substantive governance and other standards being proposed today to strengthen the independence of SROs and their regulatory functions, the Commission is not at this time proposing to require an exchange or association to impose ownership and voting restrictions on persons other than members. For the time being, however, the Commission intends to maintain its current policies in this area while it considers whether to adopt ownership and voting restrictions that apply only to members.

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[210] *See* proposed Rules 6a–5(n)(5)(ii) and 15Aa–3(n)(5)(ii).

[211] For example, this information could include the name of the member, or the member's customer, submitting the order for execution, and the terms of the order.

[212] *See* proposed Rules 6a–5(n)(5)(i)(C) and 15Aa–3(n)(5)(i)(C).

[213] *See* proposed Rules 6a–5(n)(5)(ii) and 15Aa–3(n)(5)(ii). The Commission notes that, of course, nothing in the proposed rules would limit in any way the Commission's authority to access SRO information or the ability of any SRO and its officers, directors, employees, and agents to provide any information to the Commission.

[214] *See* Sections 6(b)(8) and 15A(b)(9) of the Exchange Act, 15 U.S.C. 78f(b)(8) and 78*o*–3(b)(9).

[215] 15 U.S.C. 78f(b) and 78*o*–3(b).

[216] *See* proposed Rules 6a–5(o) and 15Aa–3(o).

[217] *See, e.g.*, Securities Exchange Act Release Nos. 49718 and 49098, *supra* note 61.

[218] *See* Securities Exchange Act Release Nos. 50170, *supra* note 65 and 49067, *supra* note 59.

[219] 15 U.S.C. 78s(b) and 17 CFR 240.19b–4.

[220] *See* Securities Exchange Act Release No. 50170, *supra* note 65.

[221] *See* Securities Exchange Act Release Nos. 49718 and 49098, *supra* note 61.

[222] In each of these instances, members' ownership interest was limited to 20%, with no process for members to exceed that limitation.

[223] When the Commission approved the demutualization of PCX and the operation of BOX as a facility of the BSE, there were shareholders that owned more than 20%. In each case, the rules of the exchange required the controlling shareholder to consent to the Commission's jurisdiction; to provide that the books and records of the shareholder shall be deemed to be the books and records of the SRO (to the extent they are related to the exchange's or facility's activities); to agree and consent (on behalf of its officers and directors) that its officers and directors would be deemed to be officers and directors of the SRO (to the extent they are related to the exchange's or facility's activities); and to agree (on its own behalf and that of its officers and directors) to cooperate with the Commission and the SRO in the performance of their regulatory oversight responsibilities. *See* Securities Exchange Act Release Nos. 49718, *supra* note 61 and 49067, *supra* note 59. The Commission is not at this time proposing such requirements for controlling shareholders of an SRO or a facility.

[224] The definition of ''related person'' also would include all members that are natural persons, either because they are registered brokers or dealers, or because they are ''related persons'' of the broker or dealer with which they are associated. *See infra* Section II.B.9.a.

The proposed rules would apply to all exchanges and associations, not just demutualized ones. Although the proliferation of demutualized exchanges and shareholder-owned facilities has highlighted the concern with member control of an SRO, the Commission believes these concerns are equally applicable to SROs that continue to be mutual organizations.[225]

Specifically, proposed Rules 6a–5(o)(1) and 15Aa–3(o)(1) would require the rules of a national securities exchange and a registered securities association to prohibit any member that is a broker or dealer, alone or together with its related persons, from either:

• Directly or indirectly beneficially owning [226] any interest in the exchange or association, or a facility of the exchange or association through which the member is permitted to effect transactions, that exceeds 20% of any class of securities or other ownership interest of the exchange, association or facility; or

• Voting any interest in such exchange, association or facility of the exchange or association through which the member is permitted to effect transactions, that exceeds 20% of the voting power of any class of securities or other ownership interest of such exchange, association or facility.[227]

Thus, a member that is a broker or dealer would not be able to, alone or together with its related persons, own more than 20% of the exchange or association of which it is a member or a facility through which the member is permitted to effect transactions. A member that is a broker or dealer, and its related persons, also would not be able to vote or cause the voting of more than 20%. The rules of the SRO would be required to prohibit both; they would not be able to prohibit only one or the other.

The Commission preliminarily believes that a member ownership and voting limit of 20% is an appropriate threshold because it precludes situations where a member would have a realistic probability of being able to exert undue influence over its SRO, yet refrains from interfering in an SRO's organizational processes or the desire by members to acquire equity interests in their markets. In some Commission rules, a 10% ownership threshold is used to determine ''control.'' [228] Accordingly, the Commission considered whether 10% would be a more appropriate threshold to propose for member ownership and voting limitations, given the concerns regarding the conflict of interest if a member were to control its regulator. The Commission recognizes, however, that generally the existing standard that exchanges have in place with respect to limits on their member's ownership in and voting of interests in the exchange or a facility is 20%, and that members that currently own more than 10% would have to divest themselves of any excess interest. The Commission therefore is proposing 20% as the ownership and voting threshold. The Commission requests specific comment on whether the threshold should be lower than 20%, given the concern that a member with a lesser interest may be able to influence or control the exchange or association.[229]

a. Members' Interests Aggregated With Their Related Persons. For purposes of calculating a member's ownership and voting interests, the proposed rules would aggregate a member's ownership and voting interests with those of its ''related persons.'' An exchange or association has members over which the exchange or association has regulatory authority, and these members participate in the governance and disciplinary process of the exchange or association. The Commission therefore believes that it is important to aggregate the members' ownership and voting interests with the interest of any person with whom the member may be able to act together to influence or control the exchange, association or facility. As such, the proposed rules would define ''related person'' to mean, with respect to a member that is a broker or dealer: (i) Any affiliate of the member;[230] (ii) any person(s) associated with the member;[231] (iii) any immediate family member of the member, or any immediate family member of the member's spouse, who, in each case, has the same home as the member or who is a director or officer of the exchange, association or facility or any of its parents or subsidiaries; and (iv) any immediate family member of a person associated with the member or any

[225] The Commission notes that PCX had a limitation on the number of seats that any person, associated person, or group of associated persons could own. *See* Securities Exchange Act Release No. 46098 (June 20, 2002), 67 FR 43693 (June 28, 2002) (order approving PCX rule filing to limit to 15% the number of exchange memberships that any person, associated person, or group of associated persons could, directly or indirectly, beneficially own or control the voting rights of). In connection with the demutualization of PCX, PCX replaced the limitation on the number of seats that any person, associated person, or group of associated persons could own with limitations on the amount of ownership interests and voting power that a person and its related persons could possess. *See* Securities Exchange Act Release No. 49718, *supra* note 61.

The Commission also notes that the CHX has a rule that states that the exchange will not approve a transfer or sale of a membership if the transferee (or lessor), together with any person who directly or indirectly controls, is controlled by, or under common control with, the transferee (or lessor), owns or has the voting power of 10% or more of the outstanding memberships of the exchange, unless the requirement is waived by the exchange's board for good cause shown. *See* CHX Article I, Rule 10.

[226] ''Beneficial ownership'' would be defined to have the meaning set forth in Rule 13d–3, 17 CFR 240.13d–3. *See* proposed Rules 6a–5(b)(4) and 15Aa–3(b)(5). The concept of beneficial ownership in Rule 13d–3 is designed to encompass any person or group of persons that may be able to act to influence or control an issuer. The Commission is proposing to use the same definition of beneficial ownership in this rule because it also would describe those persons or groups of persons that may be able to act to influence or control an exchange or association. However, to the extent any person beneficially owns any security or other ownership interest solely because such person is a member of a group within the meaning of Section 13(d)(3) of the Exchange Act, such person would not be deemed to beneficially own such security or other ownership interest for purposes of this section, unless such person had the power to direct the vote of such security or other ownership interest. *See* proposed Rules 6a–5(b)(4) and 15Aa–3(b)(5). The Commission is proposing to exclude beneficial ownership that results solely from being a member of a group to provide more certainty to members that would be required to comply with the limitations, in light of the impact of exceeding the ownership limit—*i.e.*, that the member will be divested of the excess interest. If a person has the right to vote the interest, however, it is important to continue to include such interest.

[227] Specifically, this requirement would prohibit a member that is a broker or dealer from directly or indirectly voting, causing the voting of, or giving any consent or proxy with respect to the voting of, any interest in the exchange, association, or facility that exceeds 20% of the voting power of any class of securities or other ownership interest of such exchange, association, or facility. See proposed Rules 6a–5(o)(1)(ii) and 15Aa–3(o)(1)(ii).

[228] *See, e.g.*, Rule 19h–1(f)(2) under the Exchange Act, 17 CFR 240.19h–1(f)(2) (defining a presumption of ''control'' to include a person that directly or indirectly has the right to vote 10% or more of the voting securities of a company) and Rule 10A–3(e) under the Exchange Act, 17 CFR 240.10A–3(e) (deeming a person not to be in control of a specified person if the person is not the beneficial owner, directly or indirectly, of more than 10% of any class of voting security of the specified person).

[229] *See infra* Section II.C.

[230] ''Affiliate'' would be defined to mean any person that, directly or indirectly, controls, is controlled by, or is under common control with, the exchange or association. *See* proposed Rules 6a–5(b)(1) and 15Aa–3(b)(1). ''Control'' would be defined to mean the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise. Any person that (i) is a director, general partner, or officer exercising executive responsibility (or having similar status or function); (ii) directly or indirectly has the right to vote 25% or more of a class of voting securities or has the power to sell or direct the sale of 25% or more of a class of voting securities; or (iii) in the case of partnership, has the right to receive, upon dissolution, or has contributed, 25% or more of the capital, is presumed to control that person. *See* proposed Rules 6a–5(b)(7) and 15A–3(b)(8).

[231] ''Person associated with a member'' would be defined to have the same meaning as in Section 3(a)(21) of the Exchange Act, 15 U.S.C. 78c(a)(21). *See* proposed Rules 6a–5(b)(16) and 15Aa–3(b)(17).

immediate family member of such person's spouse, who, in each case, has the same home as the person associated with the member or who is a director or officer of the exchange, association or facility or any of its parents or subsidiaries.[232]

For example, the parent company of a member would be considered a ''related person'' of the member. A sister affiliated company of the member also would be a ''related person'' of the member. The definition of ''related person'' also would include all members that are natural persons, either because they are registered brokers or dealers, or because they are ''related persons'' of the broker or dealer with which they are associated.

It is important to note that the proposed rules would require an exchange or association to restrict the indirect ownership and voting interests of a member that is a broker or dealer in an exchange, association or facility. The Commission believes that it is crucial to restrict the indirect ownership and voting interests of these members because if the Commission were to require an exchange or association to establish requirements only for direct—but not indirect—ownership and voting rights, the limitations could be easily circumvented. For example, if an exchange only prohibited a member from directly owning or voting shares, the member could hold its ownership interests in the exchange, association or facility through multiple subsidiaries of a holding company, thus easily circumventing the intent of the proposed rules. In addition, the ownership and voting limitations would apply to ownership and voting of interests in a parent company of the exchange or association. For example, if the exchange, association or facility was wholly-owned by a holding company, a member (alone or together with its related persons) would be prohibited from owning or voting more than 20% of the interest in the parent company because that would be an indirect ownership or voting interest in the exchange, association or facility. The proposed limitations also would apply to a member (either alone or together with its related persons) that beneficially owned more than 20% of an entity that itself owned more than 20% of an exchange, association or facility, if the person (and the entity) had the ability to vote or cause the vote, or dispose of, or cause the disposition of, the interest in the exchange, association, or facility.

b. Solicitation of Revocable Proxies. The Commission is proposing to make clear in the proposed rules that the 20% voting limitation—which includes ''causing the vote'' of more than 20% of the interests in an exchange, association or facility—would not apply to any solicitation or receipt of revocable proxies by a member, if conducted pursuant to Regulation 14A under the Exchange Act.[233] Thus, an exchange or association would be required to preserve the ability of a member to solicit and receive revocable proxies from other shareholders on such issues as alternative nominees for the board of directors, or a particular shareholder proposal. The solicitation or receipt of a revocable proxy does not transfer voting (or investment) power—*i.e.* beneficial ownership—to the person soliciting or receiving the proxy.[234] Therefore, the act of soliciting or receiving a revocable proxy should not undermine the purpose of the voting limitation because it would not constitute an agreement or other arrangement between the shareholder soliciting the proxy and a shareholder being solicited to vote a particular way. In particular, any shareholder so solicited would remain free to choose whether or not to grant a proxy, and the proxy would remain revocable up until the vote that is the subject of the proxy. The Commission notes, however, that if a member and one or more persons banded together to solicit proxies, and in addition that group agreed to vote a particular way, the agreement to vote would go beyond the soliciting or receipt of proxies and be considered to be causing the vote, or giving a consent or proxy with respect to voting, that would be in violation of the proposed voting limitation, if the aggregate amount of ownership or voting interests controlled by the group of persons so agreeing exceeded 20%.

The Commission is concerned, however, that allowing a member to solicit an ''open-ended'' proxy—one with no end date and one not for a particular purpose or meeting—from one or more shareholders would allow a member to obtain the ability to vote more than 20%. As such, the proposed rules would require an exchange or association to prohibit a member subject to the voting limitation from soliciting a proxy pursuant to an exemption contained in Rule 14a–2(b)(2) under the Exchange Act[235] with regard to a person or persons whose interest, together with the member and its related person's interests, would exceed the 20% voting limit.[236] The purpose of not allowing solicitations by members pursuant to this exemption in excess of the voting limitation is to prevent a member from soliciting proxies that are not subject to the requirements of Rule 14a–4 under the Exchange Act,[237] which requires, among other things, a form of proxy to clearly identify each matter to be acted upon, limits the authority that a proxy may confer, and limits the length of time for which a proxy is valid.[238] Thus, disallowing this exemption for members would close a potential loophole to the proposed voting limitation.

c. Requirement To Divest Ownership Interest and Restrict Voting. Proposed Rules 6a–5(o)(3) and 15Aa–3(o)(3) also would require an exchange or association to provide in its rules an effective mechanism to divest any member and its related persons of any interest owned in excess of the 20% limitation discussed above. The Commission believes that to be an effective mechanism, the rule would have to require the exchange or association to take action to reduce the member's and its related persons' ownership interest that exceeded the proposed ownership limit. In addition, proposed Rules 6a–5(o)(4) and 15Aa–3(o)(4) would require the rules of an exchange or association to be reasonably designed to not give effect to the portion of a vote by a member and its related persons that is in excess of the proposed voting limitation.

The Commission is not proposing to specify how an exchange or association would effectuate these requirements. Instead, the Commission is proposing to provide exchanges and associations flexibility to determine the best approach under relevant state law. Any mechanism adopted by an exchange or association, however, would need to be sufficient to assure that the exchange or association has a viable, enforceable mechanism to divest a member and its related persons of any interest owned in excess of, and to not give effect to the

[232] *See* proposed Rules 6a–5(b)(19) and 15Aa–3(b)(20).

[233] *See* 17 CFR 240.14a–1 through 240.14a–15. *See also* proposed Rules 6a–5(o)(2) and 15Aa–3(o)(2).

[234] *See* Securities Exchange Act Release No. 39538 (January 12, 1998), 63 FR 2854, at 2858 (Section II.G.) (January 16, 1998).

[235] Rule 14a–2(b)(2) under the Exchange Act, 17 CFR 240.14a–2(b)(2), exempts from Rules 14a–3 to 14a–6 (other than Rule 14a–6(g)), 14a–8, and 14a–10 to 14a–15 any solicitation made otherwise than on behalf of the registrant where the total number of persons solicited is 10 or fewer. *See* 17 CFR 240.14a–3 through 240.14a–6; 240.14a–8; and 240.14a–10 through 240.14a–15.

[236] *See* proposed Rules 6a–5(o)(2) and 15Aa–3(o)(2).

[237] 17 CFR 240.14a–4.

[238] *See* Rules 14a–4(a)(3), 14a–4(c)–(d), and 14a–4(d)(2)–(3) under the Exchange Act, 17 CFR 240.14a–4(a)(3), 14a–4(c)–(d), and 14a–4(d)(2)–(3).

portion of a vote in excess of, the 20% limitation. This mechanism would need to impose a requirement, not a choice, on the exchange or association to take such action to reduce the member's interest or voting power.[239] For example, an exchange could adopt rules—perhaps as part of its organizational documents—to provide that, if a member that is a broker or dealer exceeded the 20% ownership limitation, the exchange would be required to redeem that number of shares owned in excess of the 20% ownership limitation at par value.[240] Because the par value of the shares of stock is likely to be substantially less than the fair market value of the shares of stock, such a provision may act as a strong disincentive to members to exceed the limit, and cause them to more closely monitor their accumulation of ownership or voting power in an exchange, association or facility.[241] This requirement would not preclude an exchange or association from having a separate mechanism to divest a broker-dealer member whose ownership goes above 20% solely because of an issuer repurchase of its own shares. For example, an SRO could adopt rules that permit a grace period to divest shares under such circumstances. An exchange or association also could amend its rules to provide that, if a broker-dealer member were to vote, or attempt to vote, more than 20%, the exchange or association would not honor any portion of the vote in excess of 20%.[242]

d. Ability To Obtain Information. Finally, proposed Rules 6a–5(o)(5) and 15Aa–3(o)(5) would require an exchange's or association's rules to provide a mechanism for the exchange or association to obtain information relating to ownership and voting interests in the exchange, association or separate facility from any owner of any interest. The Commission believes this requirement would help an exchange or association to more closely monitor ownership and voting by its members in relation to the proposed 20% limits. For example, an exchange could amend its governing documents to require owners to provide information relating to their ownership and voting interests to the exchange upon request. Alternatively, the exchange could require owners to provide such information at specified times, such as monthly or quarterly. In addition, this requirement would provide a mechanism for an exchange or association to obtain the ownership information that the exchange or association would be required to disclose to the Commission pursuant to proposed Exhibit Q to revised Form 1 and new Form 2.[243]

10. Code of Conduct and Ethics and Governance Guidelines

The proposed governance rules would require that the rules of each exchange and association provide for a code of conduct and ethics for directors, officers and employees, and provide that any waiver of the code of conduct and ethics must be approved by the board, or the appropriate board committee.[244] The proposed rules also would require that the exchange or association prohibit any of its employees or officers from being a member of the board of directors of a listed issuer or member firm.[245]

Although the exchange or association could determine the details of its own policies, the Commission proposes that the code of conduct and ethics, at a minimum, establish policies and procedures regarding: conflicts of interest; corporate opportunities; confidentiality; fair dealing; protection and proper use of the exchange's or association's assets; compliance with laws, rules, and regulations by directors, officers and employees; and the reporting of illegal or unethical behavior. Formulation and adoption of a code of conduct and ethics would present an exchange or association with an opportunity to express its values, as well as the standards of behavior that the exchange or association wishes to set for itself.[246] The Commission believes that requiring exchanges and associations to adopt a code of conduct and ethics should help foster the ethical behavior of directors, officers and employees, because these individuals would be informed of the standards of conduct expected of them in fulfilling the responsibilities of their positions. The Commission further believes that the specific provision prohibiting employees or officers of an exchange or association from being a board member of a listed issuer or member firm is desirable to avoid the inherent conflict of interest of such a relationship.

The proposed governance rules also would require that each exchange and association adopt governance guidelines that, at a minimum, establish policies regarding: director qualification standards; director responsibilities; director access to management and independent advisors; director compensation; director orientation and continuing education; management succession; and annual performance evaluations of the board.[247] Requiring exchanges and associations to adopt governance guidelines should help promote greater awareness of the principles that are intended to guide the exchange or association in implementing good governance.

In our view, these proposals would assist exchanges and associations in fulfilling the statutory mandate that they be so organized and have the capacity to carry out the Exchange Act's purposes.[248]

11. Exemption Provision

The proposed governance rules would establish procedures for the Commission, upon written request or its own motion, to grant an exemption from the rules' provisions, either unconditionally or on specified terms and conditions, if the Commission determines that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors.[249] Pursuant to this provision, the Commission would consider and act upon appropriate requests for relief from the proposed rules' provisions and would consider the particular facts and circumstances relevant to each such request, the potential ramifications of granting any exemption, and any appropriate

[239] The Commission notes that any mechanism would need to be valid, binding, and enforceable under state law.

[240] *See, e.g.*, Securities Exchange Act Release No. 50170, *supra* note 65. The Commission notes that any redemption mechanism that reduces the number of outstanding shares of stock or other ownership interest, to be effective, would have to take into account such reduction in determining what amount would need to be redeemed to bring the member and its related persons below the 20% threshold, and to cover a situation where a reduction in the number of outstanding shares causes another owner to exceed the 20% threshold.

[241] The SRO's procedures also could provide that even a member that exceeds the ownership limitation through its own (or its related person's) actions would have the ability to sell out its excess shares prior to the SRO repurchasing them. The Commission emphasizes, however, that this ''grace period'' should be of short duration.

[242] *See, e.g.*, Securities Exchange Act Release No. 49718, *supra* note 61. The Commission notes that any such rule changes would be required to be filed pursuant to Section 19(b) of the Exchange Act and would be subject to the Commission's review and approval.

[243] *See infra* Section IV.C.9.

[244] *See* proposed Rules 6a–5(p)(1) and 15Aa–3(p)(1). This proposal is consonant with the Business Roundtable Report which recommended that, as part of good governance, ''corporations should have a code of conduct with effective reporting and enforcement mechanisms.'' *See* Business Roundtable Report, *supra* note 91, at 10.

[245] *See* proposed Rules 6a–5(p)(2) and 15Aa–3(p)(2).

[246] *See* Breeden Report, *supra* note 134.

[247] *See* proposed Rules 6a–5(q) and 15Aa–3(q).

[248] *See* Sections 6(b)(1) and 15A(b)(2) of the Exchange Act, 15 U.S.C. 78s(b)(1) and 78*o*–3(b)(2).

[249] *See* proposed Rules 6a–5(s) and 15Aa–3(s).

conditions to be imposed as part of the exemption.

12. Implementation

Because exchanges and associations in all likelihood would have to revise their governing documents to comply with the applicable rule, each exchange and association would be required to submit to the Commission proposed rule changes reflecting new rules or rule amendments no later than four months following the date of publication of final rules in the **Federal Register** (''final rules' publication date''), and those rules or rule amendments would have to be approved by the Commission no later than ten months following the final rules' publication date and operative no later than one year following the final rules' publication date.[250] By amending its existing rules, each exchange or association could tailor its governance rules to its own particular structure, as long as such rules were consistent with the Exchange Act and the proposed governance rules, if those rules ultimately are adopted by the Commission.

C. Request for Comment

The Commission seeks comments on proposed Rules 6a–5 and 15Aa–3. Also, the Commission requests that interested persons respond to the following specific questions:

Question 1. Do the proposed governance rules strike an appropriate balance? Are there provisions of the proposed rules that are unnecessary or are there other provisions that should be added? Are there aspects of the proposed rules that would be difficult for exchanges or associations to implement and, if so, why would that be the case?

Question 2. Is it appropriate to extend the proposed rules to regulatory subsidiaries?

Question 3. Is the proposal that the board of each exchange and association be composed of a majority of independent directors appropriate? Should the proposal require a different threshold, *e.g.*, a wholly independent board or independent directors constituting 75% or 66% of the board?

Question 4. Is the proposed definition of ''independent director,'' *i.e.*, that the director have no material relationship with the exchange or association or any affiliate of the exchange or association, or any member of the exchange or association or any affiliate of such member, appropriate? Is there another definition of independent director that would be preferable? Is the proposed definition of ''material relationship'' appropriate? Is an annual determination of independence appropriate, or should such determination be made more or less frequently? Have we provided enough guidance for boards to make the required independence determination? If not, what additional guidance is needed?

Question 5. Are the relationship tests set forth in the proposed rules that indicate when a director would not be considered independent appropriate? Are there aspects of these relationship tests that should be modified or clarified and, if so, why would that be the case? Is the three-year look-back period appropriate? Should the look-back period be longer or shorter? Is the scope of the proposed relationship tests appropriate? Are there other relationships that should be expressly covered so that the director could not be considered independent, *e.g.*, the Chairman of the board of a member firm or listed issuer? Is the $60,000 limit on payments received by the director, or an immediate family member, from the exchange or association appropriate? Should this amount be higher or lower? Is the proposed definition of ''immediate family member'' appropriate? Is the proposed definition of ''compensation'' appropriate? Is the 2% of recipient's yearly gross revenues or $200,000 limit on payments made to or from an exchange or association to an organization in which the director, or an immediate family member, is a partner, controlling shareholder or executive officer appropriate? Is the exclusion from the 2% gross revenues/$200,000 payments test for non-discretionary charitable contribution matching programs appropriate? Should these percentage and dollar amounts be higher or lower? Is the proposed definition of ''control'' appropriate? Is it appropriate to include in the relationship tests immediate family members and affiliates? Is the limitation on prior or current relationships with the exchange's or association's auditor appropriate?

Question 6. Many exchanges define a ''public director'' to include a person who has no material relationship with a broker or dealer. The proposed rules' definition of independent director would not expressly preclude an independent director from being associated with a non-member broker or dealer or affiliate of a non-member broker or dealer, unless such non-member broker or dealer or affiliate has a material relationship with the exchange or association. Should the proposed definition of independent director preclude a director associated with a broker or dealer or any affiliate of such broker or dealer from being considered an independent director?

Question 7. Should an executive officer of an issuer whose securities are ''primarily traded'' on an exchange or a facility of an association be precluded from being an independent director? Should this limitation cover an executive officer of any issuer of securities that are traded on the exchange or a facility of an association pursuant to unlisted trading privileges without regard to the extent of the volume of trading in those securities?

Question 8. Is the proposed requirement to remedy non-compliance with the majority independence requirement by the earlier of the next annual meeting or one year from the date of non-compliance appropriate? Is another time frame more appropriate?

Question 9. Is the proposed definition of ''Standing Committee'' appropriate? Should we require fewer or additional Standing Committees? If so, what should be eliminated or added? Is the proposed requirement that each Standing Committee be composed entirely of independent directors appropriate? Are there circumstances when this requirement would not be necessary? Are the duties of each of the Standing Committees, as proposed to be set forth in their charters, appropriate or are there duties that should be added or deleted? If so, what should be added or deleted? Are the requirements that the Standing Committees be composed solely of independent directors and report directly to the board likely to foster a greater degree of independent decision-making by the exchange's or association's governing body? If not, what would accomplish this goal? Should each Standing Committee be required to conduct an annual performance evaluation?

[250] *See* proposed Rules 6a–5(r) and 15Aa–3(r). As SROs, exchanges and associations currently are required by the Exchange Act to file with the Commission any proposed new rules or rule amendments, accompanied by a concise general statement of the basis for, and purpose of, the proposed rule change. Once an exchange or association files a proposed rule change, the Commission must publish notice of it and provide an opportunity for public comment. *See* Section 19(b)(1) of the Exchange Act, 15 U.S.C. 78s(b)(1), and Rule 19b–4 under the Exchange Act, 17 CFR 240.19b–4. The proposed rule change may not take effect unless the Commission approves it pursuant to Section 19(b)(2) of the Exchange Act, or it is otherwise permitted to become effective under Section 19(b)(3)(A) or Section 19(b)(7) of the Exchange Act. 15 U.S.C. 78s(b)(2), (b)(3)(A) and (b)(7).

The requirements that the exchanges and associations file a proposed rule change that complies with the applicable proposed rule by a specified date, and that final rules be operative by a specified date, are consistent with the Commission's approach when it adopted Rule 10A–3 under the Exchange Act. *See* Rule 10A–3 under the Exchange Act, 17 CFR 240.10A–3.

Question 10. Some SROs currently require that members of their audit committee be financially literate and/or that at least one member have accounting related financial management expertise. *See, e.g.*, PCX Rule 3.3(d) and the NYSE Audit Committee Charter. Also, Section 407 of the Sarbanes-Oxley Act and Item 401 under Regulation S-K require that listed companies disclose whether or not the Audit Committee contains at least one financial expert. Should the proposed governance rules contain a similar requirement for exchanges' and associations' Audit Committees? Are the proposed responsibilities of the Audit Committee appropriate? Should the proposed rules require the Audit Committee to prepare and publicly disclose an annual report? Are there other responsibilities that should be added? If so, which? Should any of the proposed Audit Committee responsibilities be eliminated? If so, which?

Question 11. Are the provisions relating to the fair representation requirement appropriate? Is the requirement that at least 20% of the directors be selected by members and that members be given the opportunity to select candidates who compose at least 20% of the total number of directors appropriate? Should the 20% threshold be higher or lower?

Question 12. Given the proposed fair representation requirement that at least 20% of directors be selected by members, could this factor impair the independence of those directors selected by members?

Question 13. Is the provision pertaining to the petition process appropriate? Is the requirement limiting to 10% the percentage of members necessary to put forth an alternative member candidate or candidates appropriate? Should the 10% threshold be higher or lower? Should the percentage limitation differ depending on whether members petition to nominate a single candidate or more than one candidate? Are there other ways to obtain the fair representation of members through a petition process rather than by imposing a limitation on the percentage of members necessary to put forth an alternative candidate?

Question 14. Are the other provisions relating to the proposed fair representation requirement appropriate? Specifically, is the proposed requirement that at least 20% of the members of any committee, subcommittee, or panel that is subject to the jurisdiction of the Regulatory Oversight Committee and that is responsible for disciplinary matters be composed of members of the exchange or association, appropriate? Is the proposed requirement that at least 20% of the members of any committee, subcommittee, or panel that is subject to the jurisdiction of a Standing Committee and that is responsible for providing advice with respect to trading rules or disciplinary rules be members of the exchange or association appropriate? Is the proposed minimum threshold adequate member representation to achieve the goal of fair representation? Should the proposed threshold be higher or lower than 20%?

Question 15. Is it appropriate to require that when the board considers any matter that is recommended by or otherwise is within the authority or jurisdiction of a Standing Committee, a majority of the directors who vote on the matter must be independent directors? Are there circumstances when this provision would be unnecessary?

Question 16. Is it appropriate to require that if any committee has the authority to act on behalf of the board, it must be composed of a majority of independent directors and that the board may not delegate to any committee not consisting solely of independent directors the authority to act on matters that otherwise are within the jurisdiction of a Standing Committee?

Question 17. Should the proposed rules give greater guidance on the matters that should be considered with respect to the annual performance self-evaluations and annual performance evaluation of the governance of the exchange or association by the Standing Committees?

Question 18. Is there a reason to deny SROs the flexibility of having a non-executive Chairman who is not an independent director? Do other provisions of the proposed governance rules make it unnecessary to require the Chairman to be an independent director if two individuals serve as Chairman and CEO? Should the proposed governance rules instead require that if the Chairman is not an independent director and two individuals serve as Chairman and CEO, a lead director should preside over executive sessions and over any Standing Committee meetings?

Question 19. Should the proposed governance rules require a complete separation of the positions of Chairman and CEO? Is the provision requiring the exchange or association to appoint a lead director to preside over executive sessions when a single individual serves as Chairman and CEO sufficient? Is it appropriate to require that the Chairman be prohibited from serving on a Standing Committee, unless the Chairman is an independent director?

Question 20. Are the provisions relating to the separation of regulatory functions from any market operations and other commercial interests of the exchange or association appropriate? Should the proposed governance rules require the regulatory function and market operations and other commercial interests of an exchange or association to be conducted in separate legal entities? What would be the consequences of any such requirement? Would such a requirement mitigate conflicts of interest? If so, how? Are there other requirements relating to the independence of the regulatory function that should be implemented?

Question 21. Is the proposal requiring each exchange and association to have a Chief Regulatory Officer appropriate? Are there other duties that a Chief Regulatory Officer should be required to perform? Are there other provisions that should be imposed to require his or her independence?

Question 22. Should the proposed governance rules be applied to other SROs, such as clearing agencies? Why?

Question 23. Is the requirement that officers and directors of an exchange or association not be subject to a statutory disqualification, as defined in Section 3(a)(39) of the Exchange Act, appropriate? Is there some other definition of statutory disqualification that is more appropriate? Should the definition be broader or narrower?

Question 24. Is the requirement that an exchange or association explicitly mandate that each director, in discharging his or her obligations as a director, reasonably consider all requirements applicable to the exchange or association under the Exchange Act broad enough?

Question 25. Should the proposed rules require that the exchange or association provide sufficient funding and other resources to permit the independent directors and the Standing Committees to retain independent legal counsel and other advisors in order to fulfill their responsibilities?

Question 26. Is the requirement that an exchange or association apply funds received from regulatory fees, fines or penalties only to fund programs and operations directly related to such exchange's or association's regulatory responsibilities appropriate? Is the scope of which funds would be included in the requirement clear? Is it broad enough, or are there other sources of remuneration that should be included? For instance, should issuer fees be considered regulatory fees?

Should the Commission define the term ''regulatory fees''?

Question 27. Should regulatory fees, fines, or penalties be allowed to be used to fund non-regulatory activities? If so, should there be any restrictions on activities for which such funds could be used?

Question 28. Instead of requiring exchanges and associations to use regulatory funds only to fund regulation, should the Commission permit an exchange or association to use regulatory funds for purposes other than to fund regulation if the exchange's or association's Regulatory Oversight Committee approves the use of the funds and the exchange or association submits to the Commission, pursuant to section 19(b)(2) and Rule 19b–4, both its stated policy, practice, or interpretation regarding committee approval and each proposed use of regulatory funds for other than regulatory purposes?

Question 29. Should the Commission enumerate in the proposed rules certain types of regulatory fees, fines or penalties that would fall within the prohibition? If so, what items should be included?

Question 30. Is the proposed requirement that an exchange or association implement policies and procedures to maintain the confidentiality of regulatory and certain other information appropriate?

Question 31. Is there any other type of information other than regulatory information and information required to be submitted to effectuate a transaction that an exchange or association should be required to keep confidential? Should such information include information gained in the course of applications for listing on the exchange?

Question 32. Should an exchange or association be allowed to disseminate such information (other than regulatory information), including order and trade data, in an aggregated form, as proposed? If so, are there any restrictions, in addition to those proposed, that should be required so that the information is truly aggregated?

Question 33. Is the proposed definition of ''regulatory information'' appropriate? Is it too broad? Or, should the prohibition on use of regulatory information for other than a regulatory purpose include information other than information gained in the course of carrying out regulatory obligations? If so, what information?

Question 34. Would the proposed limitations on disseminating regulatory information and information required to be submitted to effectuate a transaction restrict an exchange or association from being able to disseminate information that currently is disseminated by exchanges or associations? If so, how so?

Question 35. Should an exchange or association be allowed to disseminate order and trade data, or regulatory information, which is otherwise made public by a person other than the exchange, association, or an officer, director, employee, or agent of the exchange or association?

Question 36. Do commenters believe that it is necessary to have any ownership and voting limits?

Question 37. Should the proposed ownership and voting limitations in relation to interests in an exchange, association or a facility of an exchange or association apply to all other persons, besides members that are brokers or dealers? What specific concerns exist that imposing ownership and voting limits on other persons, not just members that are brokers or dealers, would serve to mitigate? If the Commission were to impose restrictions on other persons, should the limit be the same as for members that are brokers or dealers—20%—or should it be higher or lower? Upon which other persons should these restrictions be imposed?

Question 38. Should the Commission require that SROs impose ownership and voting limits on persons that are not statutory ''members'' but that own one or more memberships, or ''seats,'' in an exchange, but are not registered brokers or dealers and do not trade on or through the facilities of the exchange, but lease the trading right to a broker-dealer? If so, should it depend upon whether the person retains the voting rights associated with such membership?

Question 39. If the Commission were to impose ownership and voting restrictions on all persons, should the SRO and the Commission be able to permit persons to exceed the limit? If so, should the Commission impose requirements on any person that was permitted to exceed the limit? If so, what types of requirements? Should the person be required to agree to provide the Commission access to its books and records, and agree to cooperate with the Commission and the relevant SRO in the performance of their regulatory oversight responsibilities? Are there any other requirements that should be imposed?

Question 40. Is a 20% ownership and voting threshold the appropriate level? Are these thresholds too high? For instance, should the Commission prohibit ownership and voting over 10% (the level used in the definition of ''associate'' in Rule 12b–2)? Or 5% (the reporting threshold for Regulation 13D)? Or should these thresholds be higher than 20%?

Question 41. The Commission is proposing to limit a member's beneficial ownership in an SRO or facility of an SRO. The beneficiaries of an irrevocable trust are not generally deemed to beneficially own the securities in the trust, because the voting and investment power over those securities is typically held exclusively by a third party trustee. Should the Commission explicitly prohibit members from owning securities subject to the proposed prohibition through such an irrevocable trust? Are there any other forms of ownership that the Commission should require an SRO to prohibit, other than beneficial ownership?

Question 42. The Commission is proposing ownership and voting limits on members' ownership, and voting of interests, both in ''traditional'' mutually-owned SROs and in demutualized SROs. Is this appropriate? Should the Commission not limit ownership of seats, or memberships, in a mutually-owned SRO? If so, why should the Commission treat these SROs differently than demutualized SROs?

Question 43. Is there any special consideration that should be taken into account with respect to requiring a mutually-owned SRO to impose ownership and voting limits on its members' ownership in or voting of interests in the SRO and its facilities? For instance, if a member is entitled to only one vote even if it owns more than one seat or membership, would a limit on ownership be necessary? If so, how should such a limit be structured?

Question 44. Are there practical implementation issues that would be faced by exchanges and associations in devising rules to divest members that are brokers or dealers and their related persons of any interest in excess of that proposed to be permitted? What about rules reasonably designed to not give effect to the portion of a vote by a member that is a broker or dealer that is in excess of the proposed limits? If so, how could these issues be addressed?

Question 45. Are the proposed requirements that an exchange and association impose ownership and voting limits on its members that are brokers or dealers consistent with state law under which the SROs are governed? If not, please explain why that is the case.

Question 46. Should the Commission prohibit direct, but not indirect, ownership and voting over the proposed limits? Could a limit on direct ownership and voting—without a limit on indirect—easily be circumvented?

Question 47. The ownership and voting limitations as proposed would apply to ownership in or voting of interests in any facility of an exchange or association. Is this appropriate, or is it too broad? If too broad, what types of facilities should be included within the scope of the member ownership and voting limitations? How would the Commission achieve its goals by narrowing the ownership and voting limitations?

Question 48. The Commission requests comment on whether any broker-dealer members and their ''related persons'' currently own more than 20% of the interest in an exchange, association or a facility of an exchange or association. If so, the Commission requests comment on the length of time that an exchange or association should be given to allow such members to divest themselves of such interest.

Question 49. As proposed, a broker-dealer member of an exchange or association would be prohibited from owning and voting more than 20% of the securities of an exchange, association, or facility, which could include agreements not to vote. The Commission has not proposed any requirements on what would constitute a quorum for purposes of a shareholder vote, in part because broker-dealer members and other persons would be able to vote all the shares of stock they are entitled to own (*i.e.*, members can own and vote up to 20%), so there would not be a percentage of stock that is owned but not voted. The Commission recognizes, however, that a broker-dealer member theoretically could accumulate undetected ownership in violation of the 20% limit. If the member's interest was large enough, the member could, by not being present at a shareholder vote, keep a quorum from being present at a shareholder meeting. The Commission requests comment on whether it is necessary to require the exchange or association to amend its rules to prohibit such a scenario.

Question 50. Are the proposed definitions of ''affiliated,'' ''affiliated issuer,'' and ''affiliated security'' appropriate? Should the definitions be broader? Should they be narrower?

Question 51. Is the proposed definition of ''related persons'' too narrow? Or too broad? Is there any other relationship that should be included within the definition that is not? For instance, should the Commission include ownership that is acquired solely by being a member of a group?

Question 52. Is the proposed part of the definition of ''related person'' that includes any person associated with a member too broad? For example, should it be limited to those associated persons that possess, directly or indirectly, the power to direct or cause the direction of management and policies of the member, whether through the ownership of voting securities, by contract, or otherwise?

Question 53. The proposed ownership and voting limits would apply to members that are natural persons directly, if they are broker-dealers, or indirectly, through the member's associated broker or dealer. Should the Commission require that an SRO impose the ownership and voting limits directly on all members, or would it be sufficient to capture natural persons that are not brokers or dealers as ''related persons'' of their associated broker-dealer?

Question 54. Is the proposed definition of ''beneficial ownership'' appropriate for purposes of the proposed ownership limitation? Is it too narrow? Or is it too broad? What other definition would be appropriate? Should the Commission instead only require information to be filed with respect to record ownership rather than beneficial ownership? If so, how would that impact securities positions of a customer of the member for which the member holds in street name?

Question 55. How difficult would it be for an SRO to monitor ownership by broker-dealer members and their related persons under the proposed definition of related person? Would the proposed rule (Rule 17a–27) that would require broker-dealer members to report to the Commission and the relevant SRO ownership by the member and its related persons in excess of 5% help the SRO monitor the ownership and voting limits? To what extent would the proposed requirement that an SRO adopt rules permitting it to request information from its owners help SROs obtain the information they need?

Question 56. Should the Commission require exchanges and associations to allow members subject to the ownership and voting limits to solicit and receive revocable proxies under Regulation 14A of the Exchange Act, as the Commission has proposed? Or, would doing so undermine the purpose of the 20% voting limitation? Or, is not allowing ''open-ended proxies'' sufficient to mitigate any concern that the act of soliciting and receiving proxies would in and of itself provide a member the opportunity to exceed the 20% threshold? If so, would disallowing the exemption contained in Rule 14a–2(b)(2) under the Exchange Act be sufficient? Are there other situations that should be explicitly excluded from the proposed limitation?

Question 57. Should the Commission specify the manner in which an SRO must assure that if a member that is a broker or dealer violated the ownership and voting limits the exchange or association has an effective mechanism to divest a member and its related persons of any interest owned in excess of, or to not give effect to the portion of a vote in excess of, the 20% limitation? If so, what should the requirement be?

Question 58. Should the Commission require an exchange or association to have an independent party tabulate any shareholder vote, to help ensure compliance by the exchange or association and its broker-dealer members with the proposed voting limit? How should the Commission define ''independent party'' in this context?

Question 59. Are there other issues that an exchange's or association's code of conduct and ethics and governance guidelines should be required to address in addition to those identified in proposed Rules 6a–5(p) and (q) and 15Aa–3(p) and (q)?

Question 60. Are the proposed dates by which the exchange or association must file a rule change proposing the governance standards and by which the proposed rule change must be adopted by the Commission and operative by the SRO appropriate?

III. Proposed Regulation AL—National Securities Exchanges and Registered Securities Associations Listing Affiliated Securities

A. Background and Need for Proposed Regulation AL

As discussed above, competition among markets has increased dramatically over the past few years, and several SROs have demutualized or entered into arrangements with separate trading facilities.[251] As a demutualized entity, an SRO may become a publicly traded company and choose to list its securities on its own market. In addition, a facility of an SRO that has a separate legal existence and that is publicly traded currently may choose to list on its affiliated SRO. The owner of one facility of an SRO already has completed an initial public offering, and another SRO has filed a registration statement under the Securities Act with regard to its intended initial public offering.[252] The listing of securities issued by an SRO, the facility of an SRO, or an affiliate of either on the SRO would create a new conflict of interest

[251] *See supra* Section I.B.4. and note 61.

[252] *See supra* note 65.

with the SRO's statutory obligations as a regulator.

In particular, such ''self-listing'' raises questions as to an SRO's ability to independently and effectively enforce its own or the Commission's rules against itself or an affiliated entity, and thus comply with its statutory obligations under the Exchange Act.[253] For instance, the 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 its market even if the security is not in full compliance with the SRO's listing rules. In addition, self-listing may exacerbate conflicts with the SRO overseeing competitors that also may be listed on, and thus regulated by, the SRO. For example, an SRO might choose to more strictly construe and apply its listing rules to the securities of a competitor that is listed on, or that seeks to list on, the SRO than it would for its own or an affiliate's securities. Or, an SRO might be reluctant to allow additional time for the securities of an unaffiliated issuer to regain compliance with a listing rule, or may allow more time for its own securities that are self-listed.

Trading of its own securities or the securities of an affiliated issuer on the SRO also raises similar potential conflict concerns, in that 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. For example, the SRO may determine to look the other way with respect to improper trading in an affiliated security that creates the appearance of increased volume, such as through wash sales, or trading that artificially inflates or sustains the price of the stock, such as marking the close. In addition, the SRO may improperly pressure the specialist to stabilize the price of the stock. The SRO also may improperly discourage legal short sales or other types of legitimate trading practices that the SRO believed may negatively impact the value of the stock.

To date, the Commission has approved, through the rule filing process of Section 19(b) of the Exchange Act,[254] heightened reporting requirements in a particular instance in which an SRO ''self-listed'' securities issued by an affiliate.[255] Specifically, in anticipation of the listing of Archipelago Holdings (the parent company of Arca-Ex) on PCX, PCX amended its rules to require it to periodically report to the Commission regarding its oversight of the listing on PCX and trading on Arca-Ex of Archipelago Holdings' stock. PCX also amended its rules to require an annual independent audit of Archipelago Holdings' compliance with PCX's listing standards, a copy of which the exchange must provide to the Commission.[256] The Commission approved PCX's proposed rule change as consistent with the Exchange Act, stating that it would help protect against concern that PCX would not effectively enforce its rules with respect to the listing and trading of securities of an affiliate of the exchange or any entity that operates or owns a facility of the exchange.[257]

SROs currently have listing rules that would permit them to list and trade their own or ''affiliated'' securities without any additional requirements such as those adopted by PCX. Because of the conflict of interest raised by self-listing, which could result in an SRO being less vigilant in its obligations to enforce the securities laws and its own rules, the Commission is proposing additional requirements when an SRO lists and trades its own, or an affiliate's, securities. Proposed Regulation AL is designed to provide further assurance that SROs will carry out their regulatory responsibilities under the Exchange Act with respect to surveillance of affiliated securities and to provide the Commission a greater ability to monitor SROs' efforts in this regard. The Commission believes that the proposed rule would establish safeguards that would better ensure that the listing and trading of an affiliated security on an SRO complies with applicable rules of the SRO and the Commission. In addition, the Commission believes that the proposed rules would serve to mitigate the inherent conflict of interest between the SRO's responsibility to vigorously oversee the listing and trading of an affiliated security on its market and its own commercial and economic interests by providing the Commission with enhanced information and increased ability to monitor the SRO's surveillance of the affiliated security.

B. Description of Proposed Regulation AL

1. Definition of Affiliated Security

Proposed Regulation AL would define the term ''affiliated security'' [258] to mean any security issued by an affiliated issuer, except any option exempt from the Securities Act pursuant to Rule 238 under the Securities Act [259] and any security futures product exempt from the Securities Act under Section 3(a)(14) of the Securities Act.[260] The term ''affiliated issuer'' would be defined to mean: (i) With respect to a national securities exchange, the national securities exchange, an SRO trading facility of the national securities exchange, an affiliate of the national securities exchange, or an affiliate of an SRO trading facility of the national securities exchange, and (ii) with respect to a registered securities association, the registered securities association, an SRO trading facility of the registered securities association, an affiliate of the registered securities association, or an affiliate of an SRO trading facility of the registered securities association.[261] The term ''SRO

[253] *See* Sections 6(b) and 15A(b) of the Exchange Act, 15 U.S.C. 78f(b) and 78*o*–3(b).

[254] 15 U.S.C. 78s(b).

[255] *See* Securities Exchange Act Release No. 50171 (August 9, 2004), 69 FR 50427 (August 16, 2004) (approving SR–PCX–2004–76, which places additional reporting requirements on the exchange if any affiliate of the exchange or any entity that operates and/or owns a trading system or facility of the exchange lists any security on the exchange). The Commission notes that the NASD did not impose additional requirements when the securities of Nasdaq, a facility of the NASD, began trading in the OTC Bulletin Board, a service operated by the NASD.

[256] *See id.*

[257] *See id.*

[258] *See* proposed Rule 800(a)(4).

[259] 17 CFR 230.238.

[260] 15 U.S.C. 77c(a)(14). *See* proposed Rule 800(a)(4). Standardized options and security futures products are issued and guaranteed by a clearing agency. Currently, all standardized options and security futures products are issued by the Options Clearing Corporation (''OCC''). The Commission proposes to exempt standardized options and security futures products from the definition of ''affiliated security'' because the value of these instruments is not related to the value of its issuer—*i.e.*, the OCC. Instead, their value is based on the value of the security underlying the option or security futures product. Accordingly, the Commission does not believe the same conflicts exist when an SRO lists and trades standardized options and security futures products issued by an affiliate as when an SRO lists and trades other securities issued by an affiliate.

[261] *See* proposed Rule 800(a)(3). ''Affiliate'' would be defined to mean, with respect to any person, any other person that directly or indirectly controls, is controlled by, or is under common control with, the person. *See* proposed Rule 800(a)(2). ''Control'' would be defined to mean the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through ownership of voting securities, by contract, or otherwise. A person is presumed to control another person if the person (i) is a director, general partner or officer exercising executive responsibility (or having similar status or functions); (ii) directly or indirectly has the right to vote 25% or more of a class of voting securities or has the power to sell or direct the sale of 25% or more of a class of voting securities; or (iii) in the case of a partnership, has the right to receive, upon dissolution, or has contributed, 25% or more of the

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trading facility'' would be defined to mean any facility of a national securities exchange or registered securities association that executes orders in securities [262] and would capture Nasdaq's SuperMontage system, Arca-Ex and the NYSE floor. It would not, however, include the NASD's Alternative Display Facility (''ADF'') because the ADF does not execute orders. Thus, Nasdaq would be considered an affiliated issuer of the NASD because it would be an SRO trading facility of the NASD, and Archipelago Holdings would be an affiliated issuer of PCX because it would be an affiliate of an SRO trading facility of PCX.[263] The proposed definitions of affiliated security, affiliated issuer, and SRO trading facility are intended to include the securities of any entity whose interests may be so closely aligned with the SRO's interests that the same concerns are raised about the ability of the SRO to oversee such security's listing and trading as are raised by the listing and trading of the SRO's own securities.

2. Initial Listing

Proposed Regulation AL would prohibit a national securities exchange or registered securities association from approving for listing an affiliated security unless such exchange's or association's Regulatory Oversight Committee certified that such security satisfies the exchange's or association's rules for listing.[264] This requirement is intended to provide for review by an independent body of a listing process that contains a conflict of interest so as to help ensure that the exchange or association effectively carries out its obligations under Section 6 or 15A of the Exchange Act,[265] as applicable. The Commission notes that only an exchange or association, as an SRO, is permitted to establish listing rules. For instance, the listing rules for securities traded on Nasdaq are rules of the NASD. Accordingly, the NASD, not Nasdaq, would be required to comply with proposed Regulation AL.

3. Continued Listing and Trading

In addition, if an affiliated security is listed on, approved for trading on, or trades pursuant to the rules of, an exchange or association, proposed Regulation AL would impose specific reporting and notice obligations on the exchange or association. The proposal would require the exchange or association to file a quarterly report with the Commission summarizing its monitoring of the affiliated security's compliance with its listing rules.[266] This proposed requirement could require an exchange or association to evaluate an affiliated security's compliance with applicable listing rules more frequently than other securities listed on the exchange or association to comply with the quarterly filing requirement.[267] The Commission believes that requiring this report to be filed quarterly would help ensure that the SRO monitors and reports its monitoring of compliance by the affiliated security with listing rules on a frequent enough basis so as to bring to light possible concerns, without being unduly burdensome. Pursuant to the proposed rule, the exchange would be required to provide in the report factual information regarding the affiliated security's compliance with each applicable rule, both for quantitative listing standards (*e.g.* market capitalization) and qualitative standards (*e.g.* that the majority of the board of directors be independent).

In addition, the exchange or association would be required to include in the quarterly report a summary of its surveillance of the trading of affiliated securities by its members.[268] Each SRO may employ different tools and methods in carrying out its statutory obligations under the Exchange Act to monitor trading in its market by its members. The Commission therefore is not proposing to delineate each item or type of factual information that must be included in the summary of surveillance of trading. The Commission believes, however, that this report should include factual information regarding surveillance alerts, exception reports, complaints and regulatory referrals, including the steps taken by the SRO with respect to problems identified in surveillance alerts, exception reports or complaints, in relation to trading in the affiliated security.

Finally, the Commission proposes to require the exchange's or association's Regulatory Oversight Committee to approve the report before it is filed with the Commission.[269] This requirement is intended to provide an independent level of review of the report prior to submission, and would ensure that the Regulatory Oversight Committee is made aware of potential concerns regarding the listing and trading of an affiliated security.

In addition to the quarterly report described above, the exchange or association would be required to file with the Commission annually a report prepared by a third party analyzing compliance by the affiliated security with applicable listing rules of the exchange or association.[270] This requirement is intended to provide a second level of review by an entity other than the SRO of an affiliated security's compliance with the SRO's listing rules. The exchange or association also would be required to provide its Regulatory Oversight Committee a copy of this report within five business days of its receipt so that this committee is made aware of any potential concerns regarding affiliated securities' compliance with SRO listing rules.[271] This report would be required to be filed within 60 calendar days of the end of the exchange's or association's fiscal year.[272] The Commission has proposed that a copy of this report be provided to the Commission within 60 days of the end of the exchange's or association's fiscal year to coincide with the proposed requirement for annually updating Form 1 and new Form 2.[273]

Pursuant to its existing rules, an exchange or association would review an affiliated security's compliance with applicable listing rules. If the exchange or association were to believe that the affiliated security is not in compliance with any applicable listing rule, the proposal would require the SRO to notify the affiliated issuer promptly.[274] This proposed requirement likely would require exchanges and associations to

capital. *See* proposed Rule 800(a)(5). The Commission proposes to define the term ''affiliate'' consistent with its existing definitions of such terms under the securities laws, including Rules 12b–2 and 10A–3 under the Exchange Act and Rule 144 under the Securities Act, and to define ''control'' consistent with its existing definitions of such terms under the securities laws, including Form 1, Form BD and Rule 300 of Regulation ATS. These definitions are intended to include any person that would have the potential ability to influence the operation of the person specified.

[262] *See* proposed Rule 800(a)(6). The term ''facility'' would have the meaning in Section 3(a)(2) of the Exchange Act and proposed Rule 15Aa–3 under the Exchange Act. *See* proposed Rule 800(a)(7).

[263] Securities issued by Nasdaq currently trade on the OTC Bulletin Board pursuant to rules of the NASD, and would be covered by proposed Regulation AL. If securities issued by Nasdaq were to trade on Nasdaq, they also would be covered as they would be approved for trading on, and would trade pursuant to the rules of, the NASD.

[264] *See* proposed Rule 800(b)(1).

[265] 15 U.S.C. 78f and 78*o*–3.

[266] *See* proposed Rule 800(b)(2)(i)(A). The exchange or association would be required to file the report not more than 30 calendar days after the end of each calendar quarter.

[267] The Commission understands, however, that most, if not all, SROs review compliance with listing rules on at least a quarterly basis.

[268] *See* proposed Rule 800(b)(2)(i)(B).

[269] *See* proposed Rule 800(c)(i).

[270] *See* proposed Rule 800(b)(2)(ii).

[271] *See* proposed Rule 800(c)(ii).

[272] *See* proposed Rule 800(b)(2)(ii).

[273] *See* proposed Rules 6a–2(b) and 15Aa–2(b).

[274] *See* proposed Rule 800(b)(2)(iii).

amend their current rules setting forth the process for reviewing continued listing to require prompt notification to affiliated issuers of any alleged non-compliance found during routine reviews.

The proposal also would require the exchange or association, within five business days of providing such notice to the affiliated issuer, to file a report with the Commission identifying the date the SRO alleged that the affiliated security was not in compliance, the listing rule at issue, the action the exchange or association proposes to take with respect to the affiliated security, and any other material information conveyed to the affiliated issuer in the notice of non-compliance (a ''non-compliance report'').[275] The exchange's or association's Regulatory Oversight Committee would be required to approve this non-compliance report prior to filing with the Commission.[276] Finally, the exchange or association also would be required to provide the Commission and the exchange's or association's Regulatory Oversight Committee with a copy of any response received from the affiliated issuer regarding its alleged noncompliance within five business days of receipt of the response.[277]

The Commission believes that requiring the exchange or association to provide to the Commission a non-compliance report and a copy of any response from an affected affiliated issuer within five business days of receipt would provide the Commission with timely information but still provide sufficient time for the exchange or association to prepare and file the report and to file the response. The Commission believes that requiring the Regulatory Oversight Committee to approve the non-compliance report before it is filed with the Commission, and requiring the Regulatory Oversight Committee to receive a copy of any response from the affiliated issuer, would make this committee aware of any compliance concerns regarding an affiliated security in a timely manner.

Pursuant to proposed Rule 800(e)(i), each report required to be filed under proposed Regulation AL would constitute a ''report'' within the meaning of Sections 17(a), 18(a), and 32(a) of the Exchange Act, and any other applicable provisions of the Exchange Act.[278] In addition, each report or response required to be filed pursuant to Regulation AL would be considered filed upon receipt by the Division of Market Regulation at the Commission's principal office in Washington, DC.[279]

4. Parity in Application of Listing and Trading Rules

Proposed Regulation AL also would require that, except as otherwise required by proposed Regulation AL, (i) any action taken by the exchange or association with regard to the listing of an affiliated security, including the time period granted to the affiliated issuer to come into compliance with any listing standard, be in compliance with the existing rules of the exchange or association and (ii) the exchange or association must not apply the same listing rules to affiliated securities in a manner materially different than the treatment afforded to other securities listed on the exchange or association.[280] This requirement would not preclude an exchange or association from amending its rules to apply stricter initial and continued listing standards to affiliated securities.[281] Additionally, any action taken by the exchange or association with respect to the trading of an affiliated security by the exchange's or association's members must be in compliance with the rules of the exchange or association and with federal securities laws, and must not be materially different than action taken with respect to the trading of other securities traded on the exchange or association.[282] These requirements are intended to help ensure that an exchange or association does not give preferential treatment to affiliated securities.

5. Exemption Provision

Proposed Rule 800(f) would establish procedures for the Commission to grant an exemption, upon written request or on its own motion, from the provisions of proposed Regulation AL, either unconditionally or on specified terms and conditions, if the Commission determines that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors. Pursuant to this provision, the Commission would consider and act upon appropriate requests for relief from the rule's provisions and consider the particular facts and circumstances relevant to each such request, the potential ramifications of granting any exemption, and any appropriate conditions to be imposed as part of the exemption.

C. Request for Comment

The Commission seeks general comments on all aspects of proposed Regulation AL as described above. In addition, the Commission requests that interested persons respond to the following specific questions:

Question 61. Proposed Regulation AL would place reporting and notice obligations on an exchange or association with respect to an affiliated security listed on, approved for trading on, or traded pursuant to the rules of, the exchange or association. As noted above, this would include the trading of securities issued by Nasdaq on the OTC Bulletin Board or Nasdaq, as well as the trading of an exchange's securities on the exchange or a facility of the exchange. Is the scope of the proposed rule broad enough? Is it too broad?

Question 62. How frequently should an SRO be required to file reports summarizing its monitoring of the affiliated security's compliance with the SRO's listing rules and surveillance of the trading of the affiliated securities by such SRO's members? Is quarterly reporting appropriate, or should it be more often? Or less frequent? Is this proposed reporting requirement appropriate at all?

Question 63. Should the Commission specify in the proposed rule the type of information an SRO should include in the quarterly report summarizing the SRO's surveillance of trading of affiliated securities by exchange members? For instance, should the Commission explicitly require the SRO to provide factual information on all exception reports, surveillance alerts, complaints, or regulatory referrals related to trading in the affiliated security? Is there any other particular information that should be specified?

Question 64. Under the proposal, an SRO has 60 calendar days after the end of its fiscal year to file with the Commission a report prepared by a third party analyzing compliance by the affiliated security with the SRO's listing rules. If an SRO found that an affiliated

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[275] *See* proposed Rule 800(b)(2)(iv).

[276] *See* proposed Rule 800(c)(i).

[277] *See* proposed Rule 800(b)(2)(v) and (c)(ii).

[278] 15 U.S.C. 78q(a), 78r(a), and 78ff(a). Section 17(a) of the Exchange Act imposes recordkeeping requirements on national securities exchanges and registered securities associations; Section 18(a) of the Exchange Act imposes liability for false or misleading statements with respect to a material fact in applications, reports, or documents filed pursuant to the Exchange Act or any rule or regulation thereunder; and Section 32(a) of the Exchange Act provides for penalties against any person that willfully violates any provision of, or that willfully and knowingly makes, or causes to be made, any false or misleading statements with respect to a material fact in any application, report, or document required to be filed under the Exchange Act or any rule or regulation thereunder.

[279] *See* proposed Rule 800(e)(ii).

[280] *See* proposed Rule 800(d)(i) and (ii).

[281] Of course, any such amendment would have to be filed with the Commission pursuant to Section 19(b) of the Exchange Act and the rules thereunder. 15 U.S.C. 78(s) and 17 CFR 240.19b–4.

[282] *See* proposed Rule 800(d)(iii).

security were not in compliance with any applicable listing rule of the SRO, the SRO would be required to file a report notifying the Commission within five business days of notifying the affiliated issuer of its noncompliance. In addition, the SRO would be required to provide the Commission with a copy any response from the affiliated issuer within five business days of receipt. Finally, the SRO would be required to provide its Regulatory Oversight Committee with a copy of the annual report and the response from an affiliated issuer within five business days. Are these time periods appropriate? Should they be shorter? Should they be longer?

Question 65. Should the third party preparing the annual report regarding compliance by the affiliated security with applicable listing rules of the SRO be required to be independent of the SRO? If so, how should independence be defined? Or should the SRO be allowed to have its regular auditor conduct the analysis and prepare the report, as proposed?

Question 66. Should the Commission require a third party to periodically audit an SRO's surveillance of trading in the affiliated security as well as compliance with listing rules? If so, should the Commission require that entity to be independent of the exchange or association? If so, how should independence be defined? If so, what type of entity would be qualified to undertake this analysis? What would be the cost to the SRO of hiring a third-party to conduct the audit?

Question 67. Should the Commission itself have primary responsibility for assessing compliance by the affiliated security with the exchange's or association's listing rules? If so, should the Commission determine initial compliance, as well as continued compliance? If both, how often should the Commission conduct a review?

Question 68. Are the definitions of ''affiliated issuer,'' ''affiliated security'' and ''SRO trading facility'' appropriate? Are they broad enough? For instance, should any entity be included that is not included within the proposed definition of ''affiliated issuer?'' Are they too broad?

Question 69. Should the definition of ''affiliated security'' include options and security futures products? If so, why?

Question 70. Should the Commission exclude from the definition of ''affiliated security'' any security issued by an investment company that tracks an index, such as an ETF? If so, why?

Question 71. Is the proposed definition of ''control'' appropriate? Should it be broader? Or more narrow?

Question 72. Should the Commission impose additional requirements beyond those proposed here on SROs that wish to list or trade an affiliated security? Or should the Commission prohibit outright the listing and trading on the SRO of an affiliated security? What impact would doing so have on competition, if the issuer was forced to list the security on a competing market?

Question 73. Should ''self listing'' be allowed only if the securities also are listed on another market and such other market has made an independent initial listing determination? If so, should the self-listing SRO be required to abide by the actions of the other market with regard to continuing compliance with listing rules and decisions to delist? Would the listing rules of the two markets need to be comparable?

Question 74. Should the Commission require an SRO that lists or trades an affiliated security to contract with another SRO to monitor an affiliated security's compliance with the affiliated SRO's listing rules, and to monitor trading in the affiliated security by the affiliated SRO's members?

Question 75. Are there other requirements that the Commission should impose to address the conflicts of interest?

IV. Disclosure by SROs

A. Overview of Proposed Amendments to Registration Forms for Exchanges and Associations

The Commission proposes to amend the procedures for the registration of exchanges and associations and the filing of amendments and supplements to the registration application. These proposals are intended to bring greater transparency to the governance structure of SROs and to their regulatory programs and processes, and to provide the mechanism for more timely disclosure of the specified information. The enhanced disclosure requirements are designed to assure that users of exchange or association facilities, investors, and others have access to current and relevant information about SROs, including their administration, regulatory programs and ownership structure. Moreover, improving the transparency of SROs would enable their members, market participants, investors and regulators to more readily monitor the effectiveness and performance of SROs and promote greater accountability by SROs with respect to their Exchange Act obligations.

In addition, the proposals should assist the Commission in its oversight of exchanges and associations and help make its oversight programs more effective by requiring better and more frequent disclosure of important SRO information, particularly with respect to the governance of SROs, their regulatory programs and expenditures on those programs, and the ownership of SROs and their facilities. Along with proposed Rule 17a–26 under the Exchange Act,[283] which would require SROs to provide the Commission with periodic information about specific aspects of their regulatory programs, the proposals to improve SRO transparency should help the Commission better identify and respond to regulatory issues and concerns promptly and effectively.

Further, the proposals would provide for greater uniformity in the regulatory treatment of exchanges and associations by mandating similar disclosure for both exchanges and associations. Under the current disclosure framework, exchanges are required to provide more detailed information on Form 1 than associations are required to submit on applicable registration forms. In the Commission's view, there does not appear to be a sound reason today for maintaining differing disclosure requirements. National securities exchanges and registered securities associations are charged with nearly identical obligations under the Exchange Act.[284] Among other requirements, both exchanges and associations must be so organized and have the capacity to carry out the purposes of the Exchange Act and comply with, and enforce their members' compliance with, the federal securities laws and rules thereunder and SRO rules.[285] The proposal therefore seeks to more closely align the regulatory disclosure framework for exchanges and associations.

B. Description of Registration Processes

1. Registration as a National Securities Exchange or Exemption From Such Registration Based on Limited Volume

Section 6(a) of the Exchange Act [286] generally provides that an exchange may be registered as a national securities exchange by filing with the Commission an application for

[283] *See* infra Section V.

[284] *See supra* Section I.A.

[285] Sections 6, 15A, and 19 of the Exchange Act, 15 U.S.C. 78f, 78*o*–3, and 78s, among others, establish a statutory scheme with respect to the responsibilities imposed on and Commission oversight of SROs. The statutory scheme vests SROs that are national securities exchanges and registered securities associations with nearly identical responsibilities and imposes upon the Commission virtually the same oversight requirements with respect to such exchanges and associations.

[286] 15 U.S.C. 78f(a).

registration in such form as the Commission, by rule, may prescribe. The application must contain the rules of the exchange and such other information and documents as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.[287]

Currently, under Rule 6a–1 under the Exchange Act, an exchange applying for registration as a national securities exchange, or for an exemption from such registration based on limited volume, is required to file its application with the Commission on Form 1.[288] Form 1 requires applicants to provide general identifying information (*e.g.,* name, address, telephone, and legal status), as well as more specific information, as set forth in exhibits attached to the Form.[289] In addition, Rules 6a–1 and 6a–2 under the Exchange Act[290] set forth the application procedures and timing requirements for registration as a national securities exchange, or for an exemption from registration as an exchange based on limited volume, and the procedures and timing requirements for amending the application.[291]

2. Registration as a Registered Securities Association or Affiliated Securities Association

Section 15A of the Exchange Act[292] generally provides that an association of brokers and dealers may be registered as a registered securities association or as an affiliated securities association[293] by filing with the Commission an application for registration in such form as the Commission, by rule, may prescribe. The application must contain the rules of the association and such other information and documents as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.[294]

Rules 15Aa–1 and 15Aj–1 under the Exchange Act[295] set forth the application process and timing requirements for registration as a registered securities association or an affiliated securities association, and the process for amending or supplementing such application. Rule 15Aa–1 under the Exchange Act requires an association applying for registration as a registered securities association or an affiliated securities association to file its application for registration on Form X–15AA–1.[296] Currently, Form X–15AA–1 requires an applicant to provide general organizational information (*e.g.,* name and addresses of applicant and information about the applicant's officers, directors, and committee chairs and members). An applicant also is required to identify its rules that pertain to (1) admission to association membership; (2) fair representation of membership; (3) dues and expenses; (4) business conduct; (5) protection of members; (6) disciplining of members; (7) affiliated associations; (8) dealings with nonmembers; and (9) enforcement of association rules. An applicant is required to provide additional information to the Commission as set forth in Exhibits A, B, and C to Form X–15AA–1.[297] Rule 15Aj–1 currently requires a registered securities association or affiliated securities association to update its registration statement promptly after the discovery of any inaccuracy in the statement or in any amendment or supplement thereto, either on Form X–15AJ–1 or on Form X–15AJ–2, depending on the circumstances.[298]

C. Proposed Revisions to Form 1 and New Form 2

We propose to harmonize the procedures for application as a national securities exchange and as a registered securities association and for the submission of amendments to such applications. Under the proposals, an applicant for registration as a national securities exchange or for an exemption from exchange registration based on limited volume,[299] would be required to file revised Form 1, and an applicant for registration as a registered securities association or an affiliated securities association would be required to file new Form 2.[300] The revised Form 1 and new Form 2 also would be used by an exchange or association, respectively, for submitting all amendments. Because new Form 2 would serve as the form for both initial registration of registered securities associations and for all amendments, the Commission proposes to repeal Forms X–15AJ–1 and X–15AJ–2. In addition, the proposals would require exchanges and associations to disclose more detailed information than currently is required about their governance, regulatory functions, and ownership in the registration

[287] *Id.*

[288] *See* Rule 6a–1 under the Exchange Act, 17 CFR 240.6a–1, and Form 1, 17 CFR 249.1.

[289] Currently, Form 1 requires the following material to be included as exhibits: (1) a copy of the constitution, articles of incorporation or association, and by-laws (Exhibit A); (2) a copy of all written rulings, settled practices having the effect of rules, and interpretations of any governing board or committee of the exchange (Exhibit B); (3) information regarding all affiliates and subsidiaries (Exhibit C); (4) unconsolidated financial statements for each subsidiary or affiliate of the exchange for the latest fiscal year (Exhibit D); (5) a description of the manner of operation of the electronic trading system to be used to effect transactions on the exchange (Exhibit E); (6) complete set of applications for membership, participation or subscription to the exchange or for a person associated with a member, participant, or subscriber of the exchange (Exhibit F); (7) financial statements, reports or questionnaires required of members, participants, subscribers, or other users (Exhibit G); (8) listing applications, any agreements required to be executed in connection with listing and a schedule of listing fees (Exhibit H); (9) audited consolidated financial statements for the last fiscal years of the exchange prepared in accordance with, or reconciled to, United States generally accepted accounting principles (Exhibit I); (10) information with respect to officers, governors, members of all standing committees, or persons performing similar functions, who presently hold or have held their offices or positions during the previous year (Exhibit J); (11) information with respect to persons with 5% direct ownership for non-member owned exchanged (Exhibit K); (12) description of the exchange's criteria for membership (Exhibit L); (13) information with respect to any members, participants, subscribers or other users and the information pertaining thereto (Exhibit M); and (14) a schedule of securities listed on the exchange, securities admitted to unlisted trading privileges, securities admitted to trading on the exchange which are exempt from registration under Section 12(a) of the Exchange Act, 15 U.S.C. 78*l*, and other securities traded on the exchange (Exhibit N).

[290] 17 CFR 240.6a–1 and 240.6a–2.

[291] *See infra* Section IV.D. for a description of the requirements of Rule 6a–2 under the Exchange Act.

[292] 15 U.S.C. 78*o*–3.

[293] Section 15A(d) of the Exchange Act, 15 U.S.C. 78*o*–3(d), generally provides that an association shall not be registered as an affiliated securities association unless it appears to the Commission that: (1) such association will be affiliated with an association registered as a registered securities association and (2) such association and its rules satisfy the requirements of Section 15A(b)(2)–(10) and (12). To date, no entity has registered with the Commission as an affiliated securities association.

[294] Section 15A(a) of the Exchange Act, 15 U.S.C. 78*o*–3(a).

[295] 17 CFR 240.15Aa–1 and 240.15Aj–1.

[296] *See* Rule 15Aa–1 under the Exchange Act, 17 CFR 240.15Aa–1, and Form X–15AA–1, 17 CFR 249.801.

[297] The exhibits to Form X–15AA–1, 17 CFR 249.801, require the following information: (1) copies of the association's constitution, charter, articles of incorporation or association, with all amendments thereto, and of its existing by-laws and of any rules or instruments corresponding to the foregoing (Exhibit A); (2) a balance sheet of the association together with an income and expense statement (Exhibit B); and (3) an alphabetical list of all members of the association and the member's principal place of business (Exhibit C).

[298] 17 CFR 240.15Aj–1. *See infra* Section IV.D. for a description of Rule 15Aj–1 under the Exchange Act.

[299] *See* Section 5 of the Exchange Act, 15 U.S.C. 78e.

[300] For clarity, we use the term ''revised Form 1'' to refer to the Form 1, as proposed to be amended by this rulemaking. Currently, securities associations are required to register on Form X–15AA–1 and to file amendments and supplements on Forms X–15–AJ–1 and X–15–AJ–2. The Commission proposes to redesignate Form X–15AA–1 as Form 2 and to amend Form 2 consistent with the proposals contained in this release. For clarity, we refer to the registration form for registered securities associations, as proposed to be amended, as ''new Form 2.''

application and subsequent amendments thereto.

The Commission also proposes to amend Rules 6a–2, 15Aa–1, and 15Aj–1 under the Exchange Act (and to redesignate Rule 15Aj–1 as Rule 15Aa–2), as discussed below.[301] Among other things, the proposed changes to these rules would require exchanges and associations to submit any amendments to revised Form 1 or new Form 2 on a more timely basis. Further, the proposals would mandate the posting of amendments to revised Form 1 and new Form 2 on the Internet Web site of the exchange or association.[302]

The following subsections will set forth the scope of the proposed disclosures required by revised Form 1 and Form 2; describe those Exhibits to revised Form 1 and new Form 2 that would require enhanced disclosures; and discuss the current Exhibits to Form 1 that the Commission proposed to retain in revised Form 1 (in the same or substantially the same for mat) and to incorporate into new Form 2.

1. Scope of Disclosures Required by Revised Form 1 and New Form 2

We propose to require more detailed information, and, in some cases, new information from exchanges and associations on revised Form 1 and new Form 2. These disclosures would supplement the Commission's proposals to impose new substantive standards with respect to SRO governance, administration and ownership, and SRO reporting requirements.[303]

Further, the revisions to the registration forms for exchanges and associations also are intended to update and modernize the forms by taking into account new ways in which SROs are organized. Thus, the requirements of revised Form 1 and new Form 2 would be applicable to exchanges and associations, respectively, and also any ''facility'[304] (including an ''SRO trading facility'') [305] of an exchange or association that is a separate legal entity, and any ''regulatory subsidiary'' [306] of an exchange or association.[307] By expressly referring to a facility and regulatory subsidiary, the forms are intended to elicit complete information about the exchange or association. In our view, the trend in recent years of SROs to delegate to separate legal entities functions arising out of their obligations under the Exchange Act necessitates enhanced disclosure about those regulatory subsidiaries that perform the duties on behalf of an SRO. Moreover, an SRO trading facility may be contained in a separate entity and may be owned or operated by the SRO or another entity.[308] The Commission notes that even if an SRO enters into an agreement or arrangement to delegate certain self-regulatory duties to a subsidiary, the SRO itself, and not the regulatory subsidiary, retains the ultimate responsibility and primary liability under the Exchange Act for self-regulatory failures. The SRO's obligations under the Exchange Act extend to the operation and administration of any regulatory subsidiary.

Therefore, revised Form 1 and new Form 2 expressly would require exchanges and associations to provide information about any facility and regulatory subsidiary in various Exhibits. This disclosure should more fully inform market participants and the public of the structure and governance of exchanges and associations in today's market environment and thus should help promote investor confidence in the administration of U.S. securities markets.

2. Composition, Structure, and Responsibilities of the Board

Proposed Exhibit C of revised Form 1 and new Form 2 would require each exchange and association, respectively, to describe the composition, structure, and responsibilities of its board.[309] This description would include a list of all directors who presently hold or have held their positions during the previous year, indicating each director's name, title, dates of commencement and termination of term or position, and type of business in which the director is primarily engaged. This information currently is required by Exhibit J to Form 1 and would be incorporated into revised Form 1 and new Form 2.

The Forms also would require the identification of any board member who is an independent director and the basis for the affirmative determination that such board member is independent. The determination of whether a director is an ''independent director'' would be made according to the criteria set forth in proposed new Rules 6a–5(b)(12) and 15Aa–3(b)(13).[310] Exchanges and associations also would be required to provide a description of any affiliations or relationships that reasonably could affect the director's judgment or decision-making as a director, *i.e.*, whether the director has a material relationship [311] that would render the director ineligible to be considered an ''independent'' director. The Commission notes that the proposed disclosures are intended to bolster the requirements of proposed Rules 6a–5 and 15Aa–3 under the Exchange Act.[312] The Commission further believes that such disclosures would aid market participants, investors, and the Commission in determining whether exchanges and associations are complying with the proposed requirement that their boards be composed of a majority of independent directors and in ascertaining any affiliations and relationships that would preclude directors from being considered independent.

In addition, if the board's Chairman and CEO are the same person, the exchange or association would be required to indicate the director that is designated as the lead independent director. These disclosure items would correspond with the requirement in proposed Rules 6a–5(m)(3) and 15Aa–

[301] *See infra* Sections IV.D. through IV.F., inclusive.

[302] The proposals would not require the posting of an applicant's initial Form 1 or Form 2 on the applicant's Web site, because the Commission generally files the initial application on its own Web site when it publishes the applicant's proposed rules for public comment.

[303] *See supra* Section II., relating to proposed new Rules 6a–5 and 15Aa–3 under the Exchange Act, and Section V., relating to proposed new Rule 17a–26.

[304] For purposes of revised Form 1, the term ''facility'' would have the same meaning as in Section 3(a)(2) of the Exchange Act, 15 U.S.C. 78c(a)(2). For purposes of new Form 2, the term ''facility'' would have the same meaning as in proposed Rule 15Aa–3(b)(11). *See* proposed Instructions to revised Form 1 and new Form 2.

[305] The term ''SRO trading facility'' would mean any facility of a national securities exchange or registered securities association that executes orders in securities. *See* proposed Instructions to revised Form 1 and new Form 2.

[306] The term ''regulatory subsidiary'' would be defined as any person that, directly or indirectly, is controlled by the exchange or association and provides, whether pursuant to contract, agreement or rule, regulatory services to or on behalf of the exchange or association. *See* proposed Instructions to revised Form 1 and new Form 2. For example, several SROs have delegated to one or more subsidiaries the responsibility to carry out certain functions arising out of the SRO's obligations under the Exchange Act. Examples include BOXR, which is a wholly-owned options regulatory subsidiary of the BSE, and PCX Equities, a wholly-owned subsidiary of PCX. *See, e.g.*, Securities Exchange Act Release Nos. 49065, *supra* note 80 and 44983, *supra* note 49.

[307] Therefore, the exchange or association must file as part of revised Form 1 or new Form 2 the information specified in various Exhibits with respect to any facility that is a separate legal entity and any regulatory subsidiary of the exchange or association. These Exhibits are Exhibits A, B, C, D, E, F, G, H, and I, which are discussed below.

[308] *See supra* note 64 and accompanying text.

[309] For a discussion of proposed Exhibits A and B to revised Form 1 and new Form 2, *see* Section IV.C.13.

[310] *See* Section II.B.2.a.

[311] *See supra* note 106 and accompanying text for the definition of ''material relationship.''

[312] *See* proposed Rules 6a–5 and 15Aa–3.

3(m)(3) that if a single individual serves as both Chairman and CEO, the board must designate an independent director as a lead director to preside over executive sessions of the board.[313]

Exhibit C also would require a discussion of the authority of the board, including any powers of the board to delegate its authority to management or any executive board or committee. Further, the exchange or association would have to describe the lines of authority between the Chairman and CEO (or between any lead independent director and the CEO, when the CEO is the Chairman). The Commission believes that such disclosure should provide market participants, investors, and the Commission with a better understanding of the administration of the exchange or association.

Finally, Exhibit C of revised Form 1 and new Form 2 would obligate the exchange or association to state the method for interested persons to communicate their concerns regarding any matter within the authority or jurisdiction of a Standing Committee directly to the independent directors. These disclosure items would correspond with the requirement in proposed Rules 6a–5(c)(9) and 15Aa–3(c)(9) that the board establish a method for interested persons to communicate their concerns regarding any matter within the authority or jurisdiction of a Standing Committee directly to the independent directors.[314] The proposed disclosure also would aid in implementing proposed Rules 6a–5(m)(3) and 15Aa–3(m)(3), which would require that the board publicly disclose the lead director's name and a means by which interested parties may communicate with the lead director.[315] The Commission believes that requiring the disclosure of such processes would make more evident to market participants, investors, and the public the opportunity to communicate with independent directors and increase their understanding of the governance and administration of exchanges and associations.[316]

3. Composition, Structure, and Responsibilities of Committees and Executive Boards

Proposed Exhibit E of revised Form 1 and new Form 2 would require a description of the structure, composition, and responsibilities of any executive board or committee of the exchange or association (including board, non-board, and mixed board/non-board committees and executive board committees).[317] The description would include a list of members of any executive board and each committee, with identifying information that includes each member's name, title, dates of term of office or position, and primary business, which is information currently required by Form 1 and would be incorporated into revised Form 1 and new Form 2. Exhibit E also would require disclosure of any affiliations or relationships that reasonably could affect the committee member's independent judgment or decision-making. Further, this Exhibit to the Forms would require the submission of a chart illustrating the complete governance structure of the exchange or association and any facility or regulatory subsidiary of the applicant.

The Commission believes that requiring greater information about the governance structure of exchanges and associations would aid market participants, investors, and the public with greater insight into the manner in which the exchange or association is organized. Moreover, requiring identifying information about executive board directors and members of the committees of an exchange or association should aid market participants, investors, and the Commission in determining whether the executive board and committee members of exchanges and associations have any affiliations or relationships that could influence their judgment. Further, the Commission believes that requiring disclosure of the SRO's complete governance structure in a chart would present important information in a clear format and thus assist investors and market participants in their understanding of the SRO's organization from a governance perspective.

In addition, the exchange or association would be required to provide a copy of the written charter of each Standing Committee of the exchange's or association's board. Under proposed Rules 6a–5 and 15Aa–3, each Standing Committee must have a written charter that sets forth the Committee's purpose and responsibilities. In our view, requiring the disclosure of Standing Committee charters would prove useful to market participants, investors, and the public, because they could gain an understanding of the duties of key committees of exchanges and associations. The Commission further notes that this requirement would supplement the provisions of proposed Rules 6a–5 and 15Aa–3, which would require the Standing Committees of the boards of exchanges and associations to have written charters.[318]

In the Commission's view, the disclosure requirements of Exhibit E would further the Exchange Act's requirements for registration that exchanges and associations be so organized and have the capacity to carry out their statutory obligations.[319]

4. Governance

a. Governance Guidelines. Exchanges and associations would have to provide as part of proposed Exhibit F to revised Form 1 and new Form 2 a copy of their governance guidelines and the governance guidelines of any regulatory subsidiary. We believe that requiring exchanges and associations to disclose their governance guidelines would further heighten SRO awareness of the need for good governance and help foster SROs' compliance with their obligations under Sections 6 and 15A of the Exchange Act.[320] Increased transparency also would aid market participants, investors and the public by providing them with greater knowledge of the governance guidelines of exchanges and associations. Further, the proposed disclosures would supplement the provisions under proposed Rules 6a-5(q) and 15Aa-3(q), which would require exchanges and associations, respectively, to adopt governance guidelines and would set forth the minimum criteria that the governance guidelines would address.[321]

b. Code of Conduct and Ethics. Proposed Exhibit F to revised Form 1 and new Form 2 would require exchanges and associations to file a copy of the code of conduct and ethics for directors, officers, and employees of the exchange or association. In addition, the exchange and association would be required to disclose any waivers of the code of conduct and ethics for directors, officers, or employees. The Commission believes that requiring disclosure of exchanges' and associations' codes of conduct and ethics should provide

[313] *See supra* Section II.B.7.

[314] *See supra* Section II.B.2.b.

[315] *See supra* Section II.B.7.

[316] *See* Sections 6(b)(1) and 15A(b)(2) of the Exchange Act, 15 U.S.C. 78f(b)(1) and 78*o*–3(b)(2).

[317] For example, the NYSE maintains a Board of Executives composed of representatives of members, significant investors, and listed companies. *See* NYSE Constitution, Article V, Section 2.

[318] *See supra* Section II.B.3. For purposes of proposed Rules 6a–5 and 15Aa–3, the term ''Standing Committees' means the following committees of the board: Nominating Committee, Governance Committee, Compensation Committee, Audit Committee, and Regulatory Oversight Committee, or their equivalent.

[319] *See* 15 U.S.C. 78f (b) and 78*o*–3(b).

[320] 15 U.S.C. 78f and 78*o*–3.

[321] *See supra* Section II.B.10.

market participants, investors, and the public with useful information about the ethical standards that these SROs have set for their directors, officers, and employees. In addition, disclosure of waivers of the code of conduct and ethics should give market participants, investors, the public, as well as regulators, the opportunity to evaluate the board's performance with respect to adherence to the code of conduct and ethics and the circumstances under which it has determined to grant waivers. Further, the proposal would complement the requirements of proposed Rules 6a–5(p) and 15Aa–3(p), which would require exchanges and associations to adopt a code of conduct and ethics for directors, officers, and employees, and also would require the board or appropriate board committee to approve any waiver of the code of conduct and ethics.[322]

5. Organizational Charts

Proposed Exhibit G to revised Form 1 and new Form 2 would require exchanges and associations to submit a chart or charts illustrating fully the internal organizational structure of the exchange and association (and of any facility or regulatory subsidiary). The charts would need to indicate the internal divisions or departments, the responsibilities of each such division or department, and the reporting structure of each division or department, including its oversight by board committees or their equivalent. The charts should be sufficiently detailed to permit the Commission and the public to gain a complete understanding of the manner in which the exchange or association is structured and, along with the proposed governance chart requirement of Exhibit E, should be able to provide the Commission and the public with an overview of the SRO's organizational and governance structure. The Commission believes that disclosure of these organizational charts would be an important means by which to provide market participants, investors, and regulators with a better understanding of the governance structure of exchanges and associations.

6. Regulatory Program

Proposed Exhibit H to revised Form 1 and new Form 2 would require exchanges and associations to describe fully their regulatory programs. The description would include information such as member firm regulation, market surveillance, enforcement, listing qualifications, arbitration, rulemaking and interpretation, as well as the process for assessment and development of regulatory policy. Exchanges and associations would be required to submit a copy of any delegation plan or other contract or agreement relating to regulatory services that are provided to the exchange or association by a regulatory subsidiary of the exchange or association, another SRO, or a regulatory subsidiary of another SRO. The Commission believes that such enhanced transparency from an exchange or association would better inform market participants and investors about the exchange's or association's regulatory program. Moreover, such disclosure would aid the Commission in its oversight and evaluation of the exchange's and association's compliance with Exchange Act provisions.

Further, Exhibit H would require a description of the independence of the regulatory program from the market operations or other commercial interests of the exchange or association. The proposed disclosure is intended to provide transparency in connection with substantive requirements set forth in proposed new Rules 6a–5(n) and 15Aa–3(n), which would require exchanges and associations to establish standards and procedures to provide for the independence of their regulatory programs from their market operations or other commercial interests.[323]

In addition, each exchange and association would be required to discuss fully any new material regulatory issues that have arisen or any material events that have taken place in the past year, including any technology or trading issues, that relate to or otherwise may affect the exchange's or association's regulatory responsibilities or the operation of its regulatory program. The Commission believes that the discussion of such issues or events would be focused on those issues and events that would be considered by the exchange or association to be material to an assessment of the overall effectiveness of the regulatory program. Exhibit H would require exchanges and associations to discuss the effect these material issues or events may have on the mission, strategy, and future operations of the exchange's or association's regulatory program. Exchanges and associations also would be required to discuss generally any material changes that are planned for their regulatory programs. The Commission expects that the discussion would center on those changes that would impact the exchange's or association's regulatory program and its ability to fulfill its regulatory obligations under the Exchange Act.

The Commission believes that mandating enhanced disclosure regarding exchanges' and associations' regulatory programs would substantially facilitate the ability of the Commission and the public to assess the strengths and vulnerabilities of these programs. The Commission further believes that requiring exchanges and associations to provide details concerning their regulatory programs would enable regulators to conduct more effective oversight of these SROs' compliance with their obligations under the Exchange Act. In addition, requiring disclosure of an exchange's or association's regulatory program and its self-analysis of regulatory issues could help an exchange or association to focus on its capability to meet its statutory obligations under the Exchange Act[324] and to pursue necessary changes and improvements in its regulatory program.

7. Audited Financial Statements and Other Financial Information

Proposed Exhibit I to revised Form 1 would retain the current requirement that exchanges include audited financial statements for the applicant's latest fiscal year, which are prepared in accordance with (or in the case of a foreign applicant, reconciled with) U.S. generally accepted accounting principles.[325] We are proposing to incorporate this requirement in new Form 2.[326] In the Commission's view, the financial statement requirements currently imposed on exchanges should be applied to associations as well because, under the statutory framework, the obligations of exchanges and associations are nearly parallel. In addition, the exchange or association would be required to file audited financial statements for any facility of an exchange or association that is a separate legal entity and for any regulatory subsidiary.

Moreover, Exhibit I to these Forms would specify that the audited financial statements would need to be prepared

[322] *See supra* Section II.B.10.

[323] *See supra* Section II.B.8.

[324] *See, e.g.*, 15 U.S.C. 78f, 78*o*–3, and 78s.

[325] This requirement is part of Exhibit I to current Form 1.

[326] Exhibit B to current Form X–15AA–1 requires a securities association to provide a balance sheet within 30 days of the filing of the Form, together with an income and expense statement. The Commission believes that the proposed financial disclosure requirements set forth in proposed Exhibit I to revised Form 1 and new Form 2 would provide a more comprehensive view of the finances of an association and better aid the public and the Commission in their understanding of how the association would meet its obligations under Sections 15A and 19 of the Exchange Act. 15 U.S.C. 78*o*–3 and 78s. Therefore, Exhibit B to current Form X–15AA–1 would not be retained in new Form 2.

by a registered public accounting firm.[327] This requirement mirrors a standard recently imposed on reporting issuers, and conforms to existing Form 1 by retaining the requirement that exchanges include audited financial statements for the applicant's latest fiscal year.[328] The Commission believes that disclosure of audited financial statements would permit market participants, investors, and the Commission to better understand the financial resources and decisions of exchanges and associations, so as to determine whether they continue to comply with their obligations under the Exchange Act.[329]

Exhibit I to revised Form 1 and new Form 2 also would require exchanges and associations to provide more detailed financial information as a means to supplement the financial information SROs currently are required to provide. Under the proposal, the following categories of financial information would be required for the current fiscal year, and would need to be compared to the same figures for the prior fiscal year and estimated figures for the next fiscal year.

a. Budget and Revenues Devoted to Regulatory Activities. We propose to require exchanges and associations to disclose their regulatory expenses as a proportion of their total budget, and separately as a proportion of their total annual revenues. Pursuant to this provision, exchanges and associations would be required to disclose the aggregate amounts that they expend on regulatory activities, as well as the amounts that they expend on certain subcategories of regulatory activities, including supervisory activities (*e.g.,* routine examinations and oversight of member activity conducted in the regular course of business), surveillance activities (*e.g.,* manual and automated surveillance to ensure compliance with rules, such as trading rules and financial responsibility rules), and disciplinary activities (*e.g.,* enforcement activities). We propose to require the disclosure of this financial data, in part, to allow the Commission and the public to assess more fully the adequacy of the resources devoted by exchanges and associations to their regulatory programs and how these financial determinations affect their capacity to be able to carry out the purposes of the Exchange Act.[330]

b. Revenues and Expenses. Proposed Exhibit I to revised Form 1 and new Form 2 would require exchanges and associations to disclose the dollar amount of their revenues and expenses of their regulatory programs, with detailed itemization within the following broad categories: revenues; direct expenses; and allocated expenses. Exchanges and associations should provide this information for each area of their regulatory programs, such as surveillance, supervision, and discipline, and provide aggregate data for all program areas. The Commission believes that these uniform categories would provide useful information to market participants, investors, and the Commission by relaying an overview of the finances of exchanges and associations that are related to regulatory programs.

Each itemized category of revenue or expense should be accompanied by a description that permits an objective assessment of the nature of the revenues or expenses included within each category, annotated as appropriate. Proper descriptions of the itemized categories are especially important given the variation currently among the exchanges and the NASD in the way they report their itemized financial information. For example, an exchange or association should specify the underlying components or otherwise provide a description of the nature of an item labeled ''member technology fees'' to allow a complete understanding of the scope of that item.

Each of the three broad categories (revenues, direct expenses, and allocated costs) should be subdivided and itemized as specified in Exhibit I, and at a minimum, would have to include the items specified in Exhibit I to revised Form 1 and new Form 2. With respect to revenues, the Commission proposes to require exchanges and associations to provide general information on the main categories of revenues that are reported by exchanges and associations. To the extent that an exchange or association does not report a category of revenue that would be required by the Exhibit, the exchange or association should note this fact.

In particular, Exhibit I would require exchanges and associations to disclose revenues by fee categories, including regulatory fees, transaction and transaction services fees, and market information fees. The Commission notes that the category of ''regulatory fees'' would include all fees charged and earned by an exchange or association, including all member dues and assessments, that are assessed for the purpose of funding the operation of the exchange's or association's regulatory program. Exchanges and associations would be required to itemize, by category, all such regulatory fees. Disclosure of this information should allow market participants, investors, and the Commission to better assess the adequacy of the funding sources supporting an exchange's or association's regulatory program.

In addition, Exhibit I would require exchanges and associations to disclose other member dues and assessments not used for the purpose of funding regulation, as well as their transaction fees, transaction services fees, trading privileges fees, and similar fees. As with the regulatory fees, these member dues, transaction fees, and trading fees would need to be itemized by category. Exhibit I also would require exchanges and associations to disclose their revenues earned from market information fees, including market data fees, itemized by product. The proposed disclosure of this information would provide market participants, the public, and the Commission with an understanding of the other primary sources of revenue for exchanges and associations and, in particular, would permit the assessment of the relative adequacy of an exchange's or association's expenditures on its regulatory program as a proportion of its overall revenues.

Exhibit I also would require the disclosure of other categories of revenue, along with a general catch-all category. In particular, exchanges and associations would need to detail their revenues from fines and penalties resulting from disciplinary and enforcement actions, fees paid by issuers, including listing fees and issuer services, and investments of the exchange or association, including dividend and interest income. With respect to the ''other revenues'' catch-all category, an exchange or association would be required to itemize and footnote the amount disclosed to allow market participants, investors, and the Commission to obtain an understanding of the nature of the categories that comprise the ''other revenues'' category. The disclosure of these additional categories of revenue would allow market participants, investors, users of the SRO's facilities, the public and the

[327] The term ''registered public accounting firm'' would have the same meaning as under Section 2(a)(12) of the Sarbanes-Oxley Act of 2002, 15 U.S.C. 7201(a)(12). Currently, Exhibit I to Form 1 contains the requirement that audited financial statements for an exchange be covered by a report prepared by an independent public accountant.

[328] *See infra* Section IV.C.13.d. for a discussion of Exhibit J to revised Form 1 relating to financial statements of affiliates.

[329] For example, Sections 6(b)(4) and 15A(b)(5) of the Exchange Act require that the rules of exchanges and associations provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities. 15 U.S.C. 78f(b)(4) and 78*o*–3(b)(5).

[330] *See* Sections 6(b)(1) and 15A(b)(2) of the Exchange Act, 15 U.S.C. 78f(b)(1) and 78*o*–3(b)(2).

Commission to obtain a more complete understanding of an exchange's or association's total annual revenues, thereby permitting them to assess the adequacy of the exchange or association's resources devoted to fulfilling self-regulatory responsibilities.

Exhibit I would require exchanges and associations to disclose direct and allocated expenses that are incurred in connection with their regulatory activities. Direct expenses refer to the amounts an exchange or association spends on its regulatory department or unit as well as amounts expended in the performance of its regulatory activities, while allocated expenses refer to the portion of expenses incurred by non-regulatory personnel and systems which are attributed by the exchange or association, in whole or in part, to the performance of regulatory activities. The disclosure of this information would allow market participants, investors, users of the SRO's facilities, and the Commission to ascertain expenditures by an exchange or association on regulatory activities and compare those expenditures with the exchange's or association's revenues generally. The Commission stresses, however, that the amount spent by an exchange or association on its regulatory programs is not, by itself, an indication of the quality of the exchange's or association's regulatory program. Rather, an exchange's or association's expenditures relating to its regulatory program is only one factor that the Commission considers in assessing the overall adequacy of the SRO's regulatory program.

With respect to direct expenses, an exchange or association would be required to disclose the expenses it incurs in connection with its supervision of members, surveillance activities, and disciplinary activities. Specifically, Exhibit I would require exchanges and associations to disclose the aggregate personnel costs for their regulatory employees, including compensation and benefits, as well as provide compensation schedules for the Chief Regulatory Officer and all other senior regulatory personnel.[331] The Commission expects that these compensation schedules would include all forms of compensation including base compensation, bonuses, and benefits. In addition, exchanges and associations would be required to disclose expenses associated with training programs relating to the regulatory function of the exchange or association. Market participants, investors, users of the SRO's facilities, and the Commission could use this information to assess the level of compensation that is part of the SRO's regulatory budget, as well as the resources devoted to training the exchange's or association's regulatory personnel.

In addition, exchanges and associations would be required to disclose certain expenses that they incur in connection with regulatory services, including all expenses in connection with routine and for-cause examinations, investigations, and enforcement actions, with each category reported separately. As the Commission proposes that the expense categories to be disclosed in Exhibit I would be mutually exclusive, for clarity's sake, the Commission believes that this category should include expenses incurred that are not already reported under another category, such as personnel expenses. The reporting of this information would allow market participants, investors, users of the SRO's facilities, and the Commission to assess the adequacy of resources devoted by an exchange or association to its examination, investigatory and disciplinary regulatory activity. Similarly, Exhibit I would require the disclosure of information technology expenses, broken down by categories including data center costs, systems hardware and software, systems consultant fees, and electronic surveillance systems. The information technology expenses to be disclosed under this provision would include automated surveillance and information technology support provided to regulatory personnel. To the extent an exchange or association has entered into a contract or agreement with a regulatory subsidiary or another SRO to provide regulatory services to or on behalf of the exchange or association, the Commission believes that the costs associated with the contract or agreement should be disclosed separately. Finally, with respect to direct expenses, Exhibit I would require an exchange or association to disclose its occupancy and other overhead expenses, all professional services, such as independent auditors or attorneys, any depreciation and amortization, and any other expenses itemized as appropriate.

For allocated regulatory expenses incurred by non-regulatory departments that directly involve or relate to an exchange's or association's regulatory function, the Commission proposes to require exchanges and associations to disclose several basic categories in sufficient detail to allow market participants, investors, users of the SRO's facilities, and the Commission to assess the nature and extent of regulatory activities performed by non-regulatory personnel or groups. Specifically, Exhibit I would require exchanges and associations to disclose personnel expenses, based on a stated percentage of employee hours devoted to regulation-related activities, as well as information technology expenses, occupancy and other overhead expenses, and other allocated costs including, but not limited to, legal fees related to regulatory activities and expenses of regulatory and business conduct committees.

Exchanges and associations also would be required to provide an itemization of their non-regulatory expenditures, including, but not limited to, personnel expenses, program expenses, systems and other technology expenses, consultants and advisors, and overhead. The disclosure of non-regulatory expenditures would provide market participants, investors, users of the SRO's facilities, and the Commission with a frame of reference against which they could consider an exchange's or association's regulatory expenditures as a portion of the exchange's or association's other expenses when using the information to assess the exchange's or association's regulatory expenditures devoted to fulfilling its self-regulatory responsibilities.

The purpose of the proposed financial disclosure requirements relating to an exchange's or association's regulatory program is to provide enhanced transparency of the regulatory and non-regulatory revenues and expenses of exchanges and associations. Accordingly, market participants, investors, users of the SRO's facilities, and the public generally, as well as the Commission, would be able to better assess, among other things, the adequacy of resources devoted by an SRO to its regulatory program and the way in which the exchange or association has utilized those resources. The assessment would be useful to the Commission and others in determining whether the exchange or association is meeting its obligations under Sections 6, 15A, and 19 of the Exchange Act, among other statutory provisions, and the rules thereunder and enforcing compliance by its members with the Exchange Act and rules thereunder and the SRO's own rules.[332] The proposed disclosures relating to regulatory revenue, in

[331] The exhibit would not require exchanges and association to identify their senior regulatory personnel by name in the compensation schedule, though identification according to position would be necessary to complete the schedule.

[332] 15 U.S.C. 78f, 78*o*–3, and 78s.

particular those relating to regulatory fees, fines and penalties, and to regulatory expenses, should help the Commission review an exchange's or association's compliance with the requirements in proposed Rules 6a–5(n)(4) and 15Aa–3(n)(4) that an exchange or association use monies received from regulatory fees, fines, or penalties only to fund the regulatory operations of the exchange or association.

c. Other Financial Disclosures. The Commission also proposes to require disclosure of a number of additional items relating to the financial condition of an exchange or association (and any separate facility or regulatory subsidiaries). In many cases, these disclosures are modeled on those disclosure requirements applicable to reporting issuers. The Commission believes that similar transparency with respect to exchanges and associations would provide market participants, investors, members of the public, and the Commission with greater knowledge to permit an assessment of how specified financially-related matters could impact an exchange's or association's performance of its statutory obligations to oversee its members and facilities. [333]

First, proposed Exhibit I would require a discussion of information necessary to an understanding of the financial condition of the exchange or association and any material changes in its financial condition. [334] Exchanges and associations also would be required to disclose all charitable contributions of the applicant (whether made directly or indirectly) in excess of $1,000 to a charity in which an executive officer or director of the applicant, or any of their immediate family members, is an executive officer or director of the charity. This proposed requirement would enable market participants, users of the exchange's or association's facilities, the public, and the Commission to be apprised of larger charitable donations where there is a nexus between officers and directors of the exchange or association, and officers and directors of the charitable organization.

Further, under Exhibit I, the exchange or association would have to incorporate a discussion of any unusual or infrequent events or transactions or any significant economic changes that have had a material effect on the financial condition of the exchange or association, and any known demands, commitments, events or uncertainties that would result in or are reasonably likely to result in a material change in financial condition. [335] The discussion should focus on events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future financial condition.

The Commission also would require a description of any significant business development involving the exchange or association, including a reorganization, merger or consolidation, acquisition or disposition of significant assets, or any other material change in business or operations. [336]

In addition, proposed Exhibit I would require exchanges and associations to describe all material contracts and all material related party transactions. In this context, material contracts and related party transactions would be those to which the exchange or association, and any facility or regulatory subsidiary is a party; any director, nominee for director, officer, member, lessee, or any immediate family member [337] of any of the foregoing persons is also a party; and either the amount involved exceeds $60,000 or it is not a contract made in the ordinary course of business of the exchange or association and any facility or regulatory subsidiary. The Commission notes that these proposals regarding material contracts and related party transactions, and the $60,000 minimum amount triggering disclosure, is consistent with the requirement for listed companies in Item 404 of Regulation S–K. [338] The Commission believes that similar required disclosures for exchanges and associations should help the Commission and the public in assessing an exchange's or association's compliance with the proposed requirements in Rules 6a–5 and 15Aa–3 that the board of an exchange or association be composed of a majority of independent directors. [339] Such disclosures should aid the Commission and the public in the determination of whether a director is independent.

Further, Exhibit I would require a description of the material commitments of the exchange or association for expenditures as of the end of the latest fiscal period, and indicate the general purpose of such commitments and the anticipated source of funds needed to fulfill such commitments. [340]

Finally, Exhibit I would require the submission of a table detailing the compensation of the exchange's or association's top five most highly compensated executives, disclosed in a manner consistent with the table required of reporting companies. [341] The mandated disclosure would include all compensation (including perquisites) and would be presented in a table comparable to that required of public companies. In addition, Exhibit I would require a description of the material terms of the employment agreements of the five most highly compensated executives of the applicant and would require the exchange or association to provide a description of the compensation provided to members of its board. In the Commission's view, the information presented in the compensation table regarding the SRO's five most highly compensated executives, the description of the material terms of their employment contracts, and the description of the compensation provided to members of the SRO's board of directors would prove useful to the Commission and the public in determining whether the compensation accorded to directors and executives appears reasonable or presents conflicts of interest that may impact the SRO's capacity to carry out the purposes of the Exchange Act and rules thereunder and the SRO's own rules.

The Commission believes that all of the financial and other related disclosures proposed to be disclosed as part of proposed Exhibit I should assist the Commission and the public in assessing the vigor of the regulatory programs of exchanges and associations. As SROs, exchanges and associations have been accorded a public trust to oversee their members and, when they

[333] *See, e.g.*, Sections 6(b)(1), 6(b)(5), 15A(b)(2) and 15A(b)(6) of the Exchange Act, 15 U.S.C. 78f(b)(1), 78f(b)(5), 78*o*–3(b)(2) and 78*o*–3(b)(6).

[334] This requirement is similar to disclosure requirements imposed on registered companies pursuant to Item 303 of Regulation S–K, 17 CFR 229.303; however, the Commission has tailored the proposed requirement to the operations of exchanges and associations. The Commission believes that requiring similar disclosure about an exchange's or association's financial condition would help the Commission and the public to determine whether the SRO has the capacity to be able to carry out the purposes of the Exchange Act. *See* Sections 6(b)(1) and 15A(b)(2) of the Exchange Act, 15 U.S.C. 78f(b)(1) and 78*o*–3(b)(2).

[335] *See id.*

[336] *See id.*

[337] The term ''immediate family member'' would mean a person's spouse, parents, children, and siblings, whether by blood, marriage, or adoption, or anyone residing in such person's home. *See* proposed Instructions to revised Form 1 and new Form 2.

[338] *See* Item 404(a) of Regulation S–K, 17 CFR 229.404(a). *See also* NASD Rule 4350(h) (defining ''related party transactions'' as transactions required to be disclosed pursuant to Regulation S–K).

[339] *See* proposed Rules 6a–5(c)(i) and 15Aa–3(c)(i).

[340] *See supra* note 334.

[341] *See* Item 402 of Regulation S–K, 17 CFR 229.402.

operate markets, remove impediments to and perfect the mechanism of a free and open market and a national market system and protect investors and the public interest, among other requirements.[342] Requiring greater disclosure of financial and other information about the regulatory programs of exchanges and associations should enable market participants, investors, and the Commission to more easily ascertain how well SROs abide by their statutory responsibilities. For these reasons, the Commission has determined to propose these enhanced disclosures of financial and other related information by exchanges and associations.

8. Relationship Between SROs, Facilities, and Their Affiliates

Proposed Exhibit P to revised Form 1 and new Form 2 would require exchanges and associations to provide an organizational chart showing the relationship between and among the exchange or association, any facility of the exchange or association, and any affiliate of the exchange, association, or facility of the exchange or association.[343] Exhibit P to revised Form 1 and new Form 2 also would require disclosure about the nature and organizational structure of the exchange, association, any facility, and any affiliate, including legal name, form of organization, and ownership structure.[344]

Exchanges and associations would be required to further disclose whether the exchange, association, facility or affiliate is a reporting issuer under Sections 12 of the Exchange Act,[345] and whether it is registered with the Commission as a broker or dealer, investment adviser, or otherwise.[346] Information also would be required concerning whether and how any facility or affiliate possesses the power, directly or indirectly, to direct or cause the direction of the management and policies of the exchange or association, whether through ownership of voting securities, by contract, or otherwise.[347] In addition, Exhibit P would require that exchanges and associations provide a description concerning the ability of any facility or affiliate to exert any influence over the exchange's or association's regulatory responsibilities.[348]

In view of the trend toward demutualization of SROs, and the increased competitive pressures under which all SROs operate, the Commission believes that the disclosures required in Exhibit P should provide relevant information to the public and the Commission about the relationships among exchanges, associations, their facilities and their respective affiliates, so that the public and Commission might better evaluate how exchanges and associations fulfill their statutory responsibilities under Sections 6 and 15A of the Exchange Act.[349] In today's rapidly evolving marketplace, the disclosures proposed to be required in Exhibit P should provide greater transparency regarding the relationships among SROs, their facilities, and their affiliates, and whether those entities have the ability to control the SRO, thus enabling members, market participants, investors, and the Commission to more readily monitor the effectiveness and performance of SROs and promote greater accountability by SROs with respect to their Exchange Act obligations to comply with, and enforce compliance by their members with, their rules and the federal securities laws.

9. Ownership

Proposed Exhibit Q to revised Form 1 and new Form 2 would require that exchanges and associations provide enhanced disclosures describing any class or series of outstanding securities or other ownership interest of the exchange, association, or a facility of the exchange or association (each would be defined as a ''Disclosure Entity''), and information on persons owning more than 5% of such class of securities or other ownership interest and the nature and extent of such ownership.[350] The 5% reporting threshold and the information proposed to be required to be disclosed about such ownership is modeled on the beneficial ownership reporting requirements of the Williams Act, embodied in Sections 13(d) and 13(g) of the Exchange Act and the rules and regulations thereunder.[351] These Exchange Act provisions are intended to provide information to the issuer and the marketplace about accumulations of securities that may have the potential to change or influence control of an issuer.[352] Similarly, the intent of the proposed disclosure requirements in proposed Exhibit Q to revised Form 1 and new Form 2 is to provide the Commission, members of an exchange or association, persons who trade on the facilities of an exchange or association, investors, and the SRO itself, more detailed information about which persons or certain groups of persons potentially could control or influence the SRO.

To begin, proposed Item 1 of Exhibit Q would require exchanges and associations to provide a description of each class or series of outstanding securities or other ownership interest (including debt) of each Disclosure Entity that includes: (1) The title of the class of securities or other ownership interest; (2) the total number of securities or other ownership interests issued and outstanding; (3) any restrictions on ownership, voting, transfers, or other disposition of such securities or other ownership interest; (4) if the securities are publicly traded, the market(s) where they trade; and (5) any other material information relating to ownership of the Disclosure Entity.[353]

Further, pursuant to proposed Item 2 of Exhibit Q, exchanges and associations would be required to provide certain information with regard to any person (alone or together with its Related Persons [354]) that directly or indirectly beneficially owns more than 5% of any class of securities or other ownership interest in a Disclosure Entity (''5% Owner'').[355] Background details would

[342] *See* Sections 6(b)(1), 6(b)(5), 15A(b)(2) and 15A(b)(6) of the Exchange Act, 15 U.S.C. 78f(b)(1), 78f(b)(5), 78*o*–3(b)(2) and 78*o*–3(b)(6).

[343] *See supra* note 230 for the proposed definition of the terms ''affiliate'' and ''control.''

[344] *See* Items 1, 2 and 3 of proposed Exhibit P to revised Form 1 and new Form 2.

[345] 15 U.S.C. 78*l*.

[346] *See* Items 4 and 5 of proposed Exhibit P to revised Form 1 and new Form 2.

[347] *See* Item 6 of proposed Exhibit P to revised Form 1 and new Form 2.

[348] *See* Item 7 of proposed Exhibit P to revised Form 1 and new Form 2.

[349] 15 U.S.C. 78f and 78*o*–3.

[350] Currently, Exhibit K to Form 1 requires certain disclosures from exchanges that have one or more owners, shareholders, or partners that are also not members of the exchange, including general information about persons owning 5% or more of the ownership interest in the exchange. Proposed Exhibit Q to revised Form 1 and new Form 2 is intended to solicit more detailed and relevant disclosure about significant owners from all exchanges and associations.

[351] 15 U.S.C. 78m(d) and (g).

[352] *See* Securities Exchange Act Release Nos. 37403 (July 3, 1996), 61 FR 36521 (July 11, 1996) and 26598 (March 6, 1989), 54 FR 10552 (March 14, 1989).

[353] *See* Item 1 of proposed Exhibit Q to revised Form 1 and new Form 2.

[354] The term ''Related Persons'' is proposed to be defined in the Instructions to revised Form 1 and new Form 2 to mean (1) with respect to any member of the exchange or association that is a broker or dealer, any related person as defined in Rules 6a–5 or 15Aa–3 under the Exchange Act; or (2) with respect to any other person: (a) Any affiliate of such person and (b) in the case of a person that is a natural person, any immediate family member of such person, or any immediate family member of such person's spouse, who, in each case, has the same home as such person or who is a director or officer of the Disclosure Entity or any of its parents or subsidiaries. *See also supra* Section II.B.9.

[355] Proposed Item 6 of Exhibit Q to revised Form 1 and new Form 2 would require that for each Disclosure Entity that is a partnership, the exchange or association provide a list of all general partners

be required to be provided about any such person, including their name, address, place of organization (for corporations), principal business or occupation, and whether the person is an officer or director of the Disclosure Entity.[356]

Furthermore, for each person that is a 5% Owner, proposed Item 2.c. of Exhibit Q would require the exchange or association to state the aggregate number and percentage of shares of a class of securities or ownership interest of such security that are beneficially owned.[357] In addition, the exchange or association would be required to indicate the aggregate number of shares or ownership interest as to which there is sole power to vote or to direct the vote, shared power to vote or to direct the vote, sole power to dispose or to direct the disposition, or shared power to dispose or to direct the disposition.[358] If any other person is known to have the right to receive or the power to direct the receipt of dividends from, or the proceeds from the sale of, such securities or other ownership interest, a statement to that effect would need to be included, and if such interest related to more than 5% of the class, such person would need to be identified.[359] Pursuant to proposed Item 3 of Exhibit Q, the exchange or association would be required to separately identify each Related Person whose ownership in the Disclosure Entity is included in the calculation of beneficial ownership required to be disclosed pursuant to proposed Item 2 of Exhibit Q, and provide the same ownership information as for the original person as would be required by proposed Item 2.c. of Exhibit Q. The exchange or association also would be required to disclose if the Related Person is an officer or director of the Disclosure Entity.[360]

The Commission notes that the proposed disclosure relating to ownership in an exchange, association, or a facility of an exchange or association would cover both direct and indirect ownership. Thus, if the exchange or facility were owned by a holding company, the exchange or association would be required to provide ownership information with regard to any person, alone or together with its related persons, that owned more than 5% of the holding company. The Commission emphasizes that the exchange's or association's responsibility to provide any disclosure pursuant to proposed Exhibit Q to revised Form 1 or new Form 2 would be independent of the obligation of any person to file with the Commission, and provide to the issuer, a Schedule 13D or 13G. Therefore, an exchange or association would be required to undertake its own due diligence to obtain and provide to the Commission the information that would be required by proposed Items 2 and 3 of Exhibit Q.

An exchange or association also would be required to state whether and how the 5% Owner, alone or with any Related Persons, possesses the power, directly or indirectly, to direct or cause the direction of the management or policies of the Disclosure Entity, whether through ownership of voting securities, by contract, or otherwise (*i.e.,* whether they have ''control'').[361] Finally, exchanges and associations would be required to describe any contracts, arrangements, understandings or relationships (legal or otherwise) among the persons and Related Persons identified in Exhibit Q, and between such persons and any other person, with respect to any securities or other ownership interest of the Disclosure Entity, including but not limited to transfer or voting of any of the securities or other ownership interest, finder's fees, joint ventures, loan or option arrangements, put or calls, guarantees of profits, division of profits or loss, or the giving or withholding of proxies, and to name the persons with whom such contracts, arrangements, understandings or relationships have been entered into.[362] The description also would be required to include such information for any of the securities or other ownership interest that are pledged or otherwise subject to a contingency the occurrence of which would give another person voting power or investment power over such securities or other ownership interest. However, disclosure of standard default and similar provisions contained in loan agreements would not be necessary.[363]

In order to more easily obtain this information, proposed Rules 6a–5(o)(5) and 15Aa–3(o)(5) would require the rules of an exchange or association to provide a mechanism for the exchange or association to obtain information from any owner of the exchange, association, or a facility of the exchange or association relating to such owner's ownership in and voting of such interest.[364] The Commission requests comment on the ability of an exchange or association to obtain the information regarding its owners and its owners' related persons necessary to calculate and report beneficial ownership interest in compliance with the proposed requirements of proposed Exhibit Q to revised Form 1 and new Form 2.

The Commission believes that each item of information proposed to be disclosed pursuant to Exhibit Q would be pertinent to providing a complete picture of which person or group of persons may control a significant stake in an SRO. The Commission believes that these disclosures proposed to be required by Exhibit Q relating to ownership of the exchange, association or a facility would provide the Commission, as well as members and users of the exchange or association (or the facilities of the exchange or association), with up-to-date information regarding a change or potential change in control of an exchange or association. In addition, requiring an SRO to gather and publicly disclose this information should provide greater accountability by the SRO with respect to the performance of its regulatory obligations and further its ability to operate in compliance with the requirements of Sections 6(b)(1) and 15A(b)(2) of the Exchange Act[365] that it be so organized and have the capacity

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and those limited and special partners that have the right to receive upon dissolution, or have contributed, more than 5% of the partnership's capital.

The term ''beneficially owns'' is proposed to be defined to have the same meaning, with respect to any security or other ownership interest, as set forth in Rule 13d–3 under the Exchange Act, as if (and whether or not) such security or other onwership interest were a voting equity security registered under Section 12 of the Exchange Act; *provided that*to the extent any person beneficially owns any security or other ownership interest solely because such person is a member of a group within the meaning of Section 13(d)(3) of the Exchange Act, such person shall not be deemed to beneficially own such security or other ownership interest for purposes of Form 1 or Form 2, unless such person has the power to direct the vote of such security or other ownership interest. *See* proposed Instructions to revised Form 1 and new Form 2 and *supra* note 226.

[356] *See* Items 2.a. and 2.b. of proposed Exhibit Q to revised Form 1 and new Form 2.

[357] For purposes of making this percentage determination, a class of securities would be deemed to consist of the amount of the outstanding securities of such class, exclusive of any securities held by or for the Disclosure Entity (the issuer), or a subsidiary of the Disclosure Entity. *See* Item 4 of Exhibit Q to revised Form 1 and new Form 2.

[358] *See* Items 2.c.i. of proposed Exhibit Q to revised Form 1 and new Form 2.

[359] *See* Items 2.c.ii. of proposed Exhibit Q to revised Form 1 and new Form 2. A listing of the shareholders of an investment company registered under the Investment Company Act of 1940 or the beneficiaries of an employee benefit plan, pension fund or endowment fund would not be required.

[360] *See* Item 3.c. of proposed Exhibit Q to revised Form 1 and new Form 2.

[361] *See* Item 5 of proposed Exhibit Q to revised Form 1 and new Form 2.

[362] *See* Item 7 of proposed Exhibit Q of revised Form 1 and new Form 2.

[363] *See id.*

[364] *See* proposed Rules 6a–5(o)(5) and 15Aa–3(o)(5) and discussion in Section II.B.9.

[365] 15 U.S.C. 78f(b)(1) and 78*o*–3(b)(2).

to be able to carry out the purposes of the Exchange Act and to comply with, and enforce compliance by its members and persons associated with members with, the Exchange Act and rules thereunder and with the rules of the exchange, and the requirements of Sections 6(b)(8) and 15A(b)(9) of the Exchange Act [366] that the rules of the exchange not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. Requiring the disclosure of this information also will allow the Commission and the public to more readily monitor the SROs' performance of their obligations. In addition, the Commission expects that the disclosure of information concerning persons owning more than 5% of an exchange, an association or a facility of an exchange or association should help the Commission more effectively oversee and regulate SROs and their facilities, especially if the SRO or facility is owned and controlled by persons who are not regulated by the Commission.

10. Listing and Trading of Affiliated Securities

Proposed Exhibit T of revised Form 1 and new Form 2 would require that exchanges and associations provide information with respect to securities listed and traded on the SRO or its facilities.[367] Among other disclosures, an exchange or association would be required to provide an explanation of the process for monitoring initial and ongoing compliance with the listing rules of the exchange or association of a security issued by the SRO, or a trading facility, or an affiliate of the SRO or trading facility, if such security were listed on the exchange or association. In addition, the exchange or association would have to explain the process for monitoring trading of the security by the members of the exchange or association, as well as the process for enforcing the exchange's or association's listing rules, trading rules, and the federal securities laws with respect to the listing and trading of the securities.[368] The Commission believes that, given the conflicts inherent in ''self-listing,'' [369] enhanced public transparency concerning the ''self-listing'' of an exchange or association (or listing by an SRO facility or affiliate of the exchange, association, or facility) should result in a greater degree of accountability by the SRO with respect to monitoring the listing by and trading of the ''affiliated'' security on the SRO or a facility of the SRO in compliance with its statutory obligations under Sections 6(b)(1) and 15A(b)(2) of the Exchange Act.[370] In addition, providing this information to the Commission should further the Commission's ability to monitor the SRO's regulation of such listing and trading of the affiliated security.

11. Location of Books and Records

Proposed Exhibit U to revised Form 1 and new Form 2 would require exchanges and associations to provide the name and address of the location where their books and records are maintained. The Commission believes that requiring exchanges and associations to provide details concerning the location of their books and records should enable the Commission to conduct more effective and efficient oversight of these SROs. The proposed disclosure also is intended to reinforce a proposed change to Rule 17a–1 under the Exchange Act [371] that would require, for the existing five-year record retention period, exchanges and associations (and registered clearing agencies and the Municipal Securities Rulemaking Board) to maintain their books and records in the United States. This requirement is intended to assure that such books and records may be made easily available for inspection and examination by the Commission pursuant to Section 17 of the Exchange Act,[372] particularly in an instance where an exchange or association is owned by a person or entity located outside the U.S.

12. Miscellaneous Matters Specific to New Form 2

Currently, applicants for registration as an affiliated securities association must provide the name of the registered securities association that the applicant association seeks affiliation with, and an estimation of the annual dollar volume of transactions effected by members of the applicant association.[373] The Commission believes that this information, which is specifically asked of applicants for affiliated securities association status, should be included on new Form 2,[374] because such identifying information is useful to the Commission in its determination of whether the association satisfies the requirements set forth in Section 15A(d) of the Exchange Act.[375]

In addition, applicants for registration as a registered securities association or an affiliated securities association are now asked to identify the rule or rules of the association that deal with membership; fair representation of members; dues and expenses; business conduct and protection of members; disciplining of members; and affiliated associations.[376] Because new Form 2 would require applicants to provide the Commission with a copy of the association's rules, the Commission believes that separately requesting that applicants identify their rules by category would be unnecessary. Therefore, the Commission proposes to omit these inquiries from new Form 2.

13. Current Disclosures To Be Retained in Revised Form 1 and Added to New Form 2

The Commission is proposing to retain in revised Form 1 and add to new Form 2 several exhibits that currently are required by Form 1 and Form X–15AA–1. In addition, the Commission proposes to incorporate in new Form 2 several disclosures currently required by Form 1. The Commission believes that the information proposed to be disclosed in these exhibits should aid the Commission in its evaluation of an application for registration as an exchange (or for an exemption from exchange registration based on limited volume) or association. In addition, the information to be disclosed in these exhibits would be relevant to the Commission and to the public in their evaluation of whether the exchange or association has rules that comply with Sections 6(b)(5) and 15A(b)(6) of the Exchange Act.[377] The disclosures should also guide the Commission (and the exchange or association) in determining whether the exchange or association meets the statutory standards for initial and continued registration as a national securities exchange or registered securities association.[378]

Further, the Commission in several instances proposes to align the

[366] 15 U.S.C. 78f(b)(8) and 78*o*–3(b)(9).

[367] *See infra* Section IV.C.13.*l.* for a discussion of current Form 1 requirements regarding securities listed and traded on an exchange or association, and their facilities, which would be retained in revised Form 1 and added to new Form 2.

[368] *See* proposed Item 5 of Exhibit T to revised Form 1 and new Form 2. *See also* discussion of proposed Regulation AL in Section III.

[369] *See supra* Section III.

[370] 15 U.S.C. 78f(b)(1) and 78*o*–3(b)(2).

[371] *See* Rule 6a–2(d) under the Exchange Act, 17 CFR 240.17a–1.

[372] 15 U.S.C. 78q.

[373] Currently, this information is required by Items 29 and 30 of Form X–15AA–1.

[374] This item would be included on the execution page of new Form 2.

[375] 15 U.S.C. 78*o*–3(d).

[376] Currently, this information is required by Items 7 through 28, inclusive, of Form X–15AA–1.

[377] *See* Sections 6(b)(5) and 15A(b)(6) of the Exchange Act, 15 U.S.C. 78f(b)(5) and 78*o*–3(b)(6).

[378] *See* Sections 6(b) and 15A(b) of the Exchange Act, 15 U.S.C. 78f(b) and 78*o*–3(b).

regulatory treatment of exchanges and associations by mandating similar disclosure for both exchanges and associations. Under the current disclosure framework, exchanges are required to provide more detailed information on Form 1 than associations are required to submit on applicable registration forms. The Commission does not believe that in today's environment the registration procedures for exchanges and associations under the Exchange Act should maintain differing disclosure requirements. National securities exchanges and registered securities associations are charged with nearly identical obligations under the Exchange Act.[379] In addition, we are proposing to enhance the transparency of governance, administration, regulation, and ownership for both exchanges and associations. This is an opportune time to review all aspects of the registration procedures and forms for exchanges and associations and propose appropriate revisions. In our view, the proposed inclusion in new Form 2 of certain Exhibits currently contained in Form 1 would align more closely the regulatory disclosure framework for exchanges and associations. Moreover, the Commission believes that the incorporation of current Form 1 requirements into new Form 2 would further the statutory goal of assuring that to be registered, and remain registered, an exchange and an association must be so organized and have the capacity to comply with, and enforce compliance by members with, the provisions of the Exchange Act, the rules thereunder, and the rules of the exchange or association.[380]

a. Constitution, Articles of Incorporation, By-Laws, and Rules. Exhibit A of current Form 1 and current Form X–15AA–1 both require that exchanges and associations provide to the Commission copies of their constitution or articles of incorporation or association, with all subsequent amendments, and of their existing by-laws or corresponding rules or instruments. This disclosure item would be retained as Exhibit A of revised Form 1 and new Form 2.

b. Rulings and Interpretations. Exhibit B of current Form 1 requires exchanges to provide a copy of all written rulings, settled practices having the effect of rules, and interpretations of the board or any committee of the exchange in respect of any provisions of the constitution, by-laws, rules, or trading practices of the exchange which were not otherwise provided as part of Exhibit A. This required disclosure item would be retained in revised Form 1, and added to new Form 2, as Exhibit B.

c. Officers. Form 1 currently requires the disclosure of the officers of the exchange or association who presently hold their offices or positions, or have held them during the previous year, with identifying information that includes each officer's name, title, dates of commencement and termination of term of office, and type of business.[381] The Commission believes that mandating associations and exchanges to disclose this information should better inform market participants, investors, and regulators about exchange and association officers. Therefore, this required disclosure would be retained in revised Form 1 and added to new Form 2, as Exhibit D.

d. Financial Statements of Affiliates. Form 1 currently requires exchanges to provide to the Commission unconsolidated financial statements for each subsidiary or affiliate for the latest fiscal year.[382] Such financial statements must consist, at a minimum, of a balance sheet and an income statement with such footnotes and other disclosure as are necessary to avoid rendering the financial statements misleading.[383] We believe that the financial statements of affiliates would be relevant to the Commission and to market participants and the public generally with respect to associations, as well as exchanges. Therefore, this required disclosure would be retained in revised Form 1, and added to new Form 2, as Exhibit J.[384] The required financial statements under proposed Exhibit J would consist of, at a minimum, a balance sheet and an income statement of cash flows, with such footnotes and other disclosure as are necessary to avoid rendering the financial statements misleading. The Commission proposes to clarify that the financial statement would include an income statement of cash flows, would clarify that separate financial statements are required for each affiliate, and would delete the reference to ''subsidiary'', in each case to conform to current accounting terminology.[385]

e. General Information Relating to Affiliates and SRO Trading Facilities. Form 1 currently requires exchanges to provide to the Commission information regarding any of their affiliates, subsidiaries and any electronic trading system to be used to effect transactions on the exchange.[386] The exchange is required to disclose identifying information about the organization of each such entity, such as name, address, form of organization, and state under which it is organized. The exchange also must describe the nature and extent of any affiliation, and the nature of the business or functions performed by the affiliate, subsidiary, or electronic trading system, including responsibilities with respect to the operation of an electronic trading system. In addition, the exchange must provide to the Commission a copy of the organizational documents of each such entity, including its constitution or articles of incorporation and by-laws, as well as a list of officers, governors, and members of standing committees. Finally, the exchange must indicate if such entity ceased to be associated with the exchange during the previous year. The exchange must provide a brief statement of the reasons for termination of the association with the entity.

We believe that knowledge of identifying and organizational information with respect to affiliates and any unaffiliated entity that operates an SRO trading facility would be useful to the Commission and to the public. This would be the case with respect to associations as well as exchanges. Therefore this disclosure item would be retained in revised Form 1, and added to new Form 2, as proposed Exhibit K.[387]

f. Operation of SRO Trading Facilities. Under current Form 1 requirements, exchanges must describe the manner of operation of any electronic trading system to be used to effect transactions

[379] *See supra* note 285.

[380] *See* Sections 6(b)(1) and 15A(b)(2) of the Exchange Act, 15 U.S.C. 78g(b)(1) and 78*o*–3(b)(2).

[381] Currently, this information is required by Exhibit J to Form 1.

[382] Currently, this information is required by Exhibit D to Form 1.

[383] If any affiliate or subsidiary is required by another Commission rule to submit annual financial statements, a statement to that effect, with a citation to the other Commission rule, may be provided along with a copy of the financial statements prepared pursuant to such other Commission rule.

[384] The Commission notes that by proposing to require disclosure only of an affiliate of an exchange or association, there is no intent to propose a substantive change to the current requirement. The Commission believes that the definition of ''affiliate'' set forth in the Instructions to revised Form 1 and new Form 2 would include a ''subsidiary,'' and by proposing to eliminate the term ''subsidiary'' from proposed Exhibit J, the Commission seeks solely to clarify the requirement.

[385] *See* Regulation S–X, 17 CFR Part 210.

[386] Currently, this information is required by Exhibit C to Form 1.

[387] The Commission notes that by proposing to require disclosure only of an affiliate of an exchange or association, there is no intent to propose a substantive change to the current requirement. The Commission believes that the definition of ''affiliate'' set forth in the Instructions to revised Form 1 and new Form 2 would include a ''subsidiary,'' and by eliminating the term ''subsidiary'' from proposed Exhibit K, the Commission, seeks solely to clarify the requirement.

on the exchange.[388] The description must include the means of access, procedures governing entry and display of quotations and orders, procedures governing the execution, reporting, clearance, and settlement of transactions, proposed fees, and procedures for ensuring compliance with usage guidelines. The exchange must also disclose the hours of operation of the electronic trading system, and the date on which the exchange intends to commence operation of the electronic trading system. If the exchange proposes to hold funds or securities on a regular basis, the exchange must provide a description of the controls that will be implemented to ensure safety of those funds or securities. Finally, the exchange is required to attach a copy of the users' manual. The Commission believes that market participants, investors, and regulators would benefit from the disclosure of information about SRO trading facilities of associations, including electronic trading systems, in addition to SRO trading facilities of exchanges. This required disclosure would be retained in revised Form 1, and added to new Form 2, as proposed Exhibit L.

g. Membership Forms Form 1 currently requires exchanges to provide a complete set of all forms pertaining to application for membership, participation or subscription to the exchange, application for approval as a person associated with a member, participant, or subscriber, and any other similar materials.[389] The current Forms for associations requires the filing of a list of members, but does not require the filing with the Commission of the forms for membership. In our view, the information required to be disclosed with respect to membership would be beneficial in the context of associations, in addition to exchanges. Therefore this required disclosure item would be retained in revised Form 1, and added to new Form 2, as proposed Exhibit M.

h. Financial Responsibility and Minimum Capital Requirements of Members. Pursuant to Form 1, exchanges must provide a complete set of all forms of financial statements, reports or questionnaires required of members, participants, subscribers, or any other users relating to financial responsibility or minimum capital requirements for such members, participants, or any users.[390] We believe that the information regarding member financial responsibility and minimum capital requirements, if any, would be relevant information to be disclosed by associations as well. Therefore, this disclosure item would be retained in revised Form 1, and added to new Form 2, as proposed Exhibit N.

i. Listing Applications. Form 1 currently requires exchanges to provide the Commission with a complete set of documents comprising its listing applications, including any agreements required to be executed in connection with listing, and a schedule of listing fees.[391] If the exchange does not list securities, the exchange must provide a brief description of the criteria used to determine what securities may be traded on the exchange. The Commission believes that information about listing and trading of securities on facilities of an association also would be useful to the Commission and to the public generally. In this way, the Commission and the public would have access to the current listing applications used by issuers, along with other materials related to the listing of securities. We therefore propose to retain the required disclosure in revised Form 1, and add it to new Form 2, as proposed Exhibit O.

j. Criteria for Membership. Form 1 currently requires exchanges to provide a description of the criteria for membership, the conditions under which members may be subject to suspension or termination with regard to access to the exchange, and any procedures that will be involved in the suspension or termination of a member.[392] In contrast, Form X–15AA–1 simply requires associations to state which of its rules deal with admissions to membership, restrictions on membership, and appeals procedures for brokers or dealers that have been denied membership.[393] The Commission believes that the information about membership criteria is relevant to the Commission and to the public generally as a means to be informed about membership eligibility requirements and the conditions under which those members can have their access to the SRO's facilities suspended or terminated. We propose that this required disclosure, in the format required by current Form 1, be retained in revised Form 1, and added to new Form 2, as proposed Exhibit R.

k. List of Members. Form 1 currently requires exchanges to provide a list of all members, participants, subscribers or other users.[394] Exchanges must also note the name of the entity with which an individual is associated and relationship to the entity, the type of activities primarily engaged [395] in by the member, participant, subscriber, or other user (*e.g.*, floor broker, specialist, odd lot dealer, other market maker, proprietary trade, non-broker dealer, inactive or other functions), and the class of membership, participation or subscription or other access. Form X–15AA–1 simply requires associations to provide a list of all of its members and the principal place of business for each of them.[396] The Commission believes that the broader Form 1 disclosure requirements should be applied to associations, as well, including information about members, participants, subscribers or other users of association facilities, if any. Thus, we propose that this disclosure be retained in revised Form 1, and added to new Form 2, as proposed Exhibit S.

l. Securities Listed and Traded. Under current Form 1 requirements, exchanges must provide a schedule of listed securities (including name of issuer and description of the security); securities admitted to unlisted trading privileges (including name of issuer and description of the security); securities admitted to trading on the exchange which are exempt from registration under Section 12(a) of the Exchange Act [397] (including the name of the issuer, a description of the security, and the statutory exemption claimed); and other securities traded on the exchange (including name of issuer and description of the security).[398] The Commission believes that information with respect to securities listed and traded on the facilities of an association, if any, would be helpful to the Commission and to market participants in ascertaining the securities that are listed and traded on an SRO's facilities. We therefore propose that this required disclosure be retained in revised Form

[388] Currently, this information is required by Exhibit E to Form 1.

[389] Currently, this information is required by Exhibit F to Form 1.

[390] Currently, this information is required by Exhibit G to Form 1. The exchange also must provide a table of contents of the forms included in the exhibit.

[391] Currently, this information is required by Exhibit H to Form 1.

[392] Currently, this information is required by Exhibit L to Form 1.

[393] *See* Form X–15AA–1.

[394] Currently, this information is required by Exhibit M to Form 1.

[395] Current Exhibit M to Form 1 states that a person shall be ''primarily engaged'' in an activity or function when that activity or function is the one in which that person is engaged for the majority of their time.

[396] Currently, this information is required by Exhibit C to Form X–15AA–1.

[397] 15 U.S.C. 78 *l*.

[398] Currently, this information is required by Exhibit N to Form 1.

1, and added to new Form 2, as Exhibit T.

D. Timing and Format of Revised Form 1 and New Form 2

In conjunction with its proposals to revise Form 1 and adopt new Form 2, the Commission also proposes to revise the rules governing the timing and format of the required disclosures by exchanges and associations. Currently, Rule 6a–2(a) under the Exchange Act [399] requires a national securities exchange, or an exchange exempted from such registration based on limited volume, to file with the Commission an amendment to its Form 1 within 10 days after any action is taken that renders inaccurate, or that causes to be incomplete: (1) Information filed on the Execution Page of Form 1 (or any amendment thereto); or (2) information filed as part of certain exhibits [400] to Form 1. In addition, Rule 6a–2(b) under the Exchange Act [401] requires an exchange to file an annual amendment to its Form 1 to update certain exhibits,[402] while Rule 6a–2(c) under the Exchange Act [403] requires an exchange to file an amendment to its Form 1 every three years to update certain other exhibits.[404] Finally, Rule 6a–2 provides exchanges with several alternatives that they may utilize in lieu of the annual filing requirement for Exhibits K, M, and N and the three-year filing requirement for Exhibits A, B, C, and J.[405] In lieu of paper filing of Exhibits A, B, C, J, K, M, and N, exchanges have the following options (''paper filing alternatives''):

(1) If the exchange publishes, or cooperates in the publication of the information required by these exhibits, on an annual or more frequent basis, the exchange may identify the publication in which such information is available, the name, address, and telephone number of the person from whom such publication may be obtained, and the price of such publication, so long as it certifies to the accuracy of the information as of its publication date;

(2) If the exchange keeps the information required by these exhibits up-to-date, and makes it available to the Commission and the public upon request, the exchange may certify that the information is kept up-to-date and available to the Commission and public upon request; or

(3) If the information required by these exhibits is available continuously on an Internet Web site controlled by the exchange, the exchange may indicate the location where such information may be found and certify that the information available at such location is accurate as of its date.[406]

Rule 15Aj–1 under the Exchange Act [407] is the companion rule for a registered securities association or an affiliated securities association and contains filing requirements similar to the provisions of Rule 6a–2. Rule 15Aj–1 currently requires an association to update its Form X–15AA–1 [408] promptly after the discovery of any inaccuracy in the registration statement or in any amendment or supplement thereto.[409] Rule 15Aj–1 also requires an association to file a current supplement on Form X–15AJ–1 [410] following any change which renders the information contained or incorporated in the registration statement or any amendment thereto no longer accurate.[411] In addition, an association is required to file a consolidated supplement to its registration statement on Form X–15AJ–2 [412] annually and a complete Exhibit A of the Form X–15AJ–2 every three years.[413] Finally, an association must file with the Commission a supplement setting forth its balance sheet following the close of each fiscal year.[414] As is the case for exchanges under Rule 6a–2, with respect to certain filings required under current Rule 15Aj–1, an association may, in lieu of filing in paper form, identify the publication in which such information is available, the name, address, and telephone number of the person from whom such information may be obtained, and the price of the publication, as long as it certifies that the information is accurate.[415]

For clarity, the Commission proposes to redesignate Rule 15Aj–1 as Rule 15Aa–2 so that it will be located with Rule 15Aa–1, the rule for registration as a registered securities association or affiliated securities association. The Commission also proposes to revise Rule 6a–2 and the redesignated Rule 15Aa–2 to enhance the frequency of disclosures by exchanges and associations, to harmonize filing and format requirements for exchanges and associations, and to streamline the disclosure process.[416]

The proposed amendments to Rule 6a–2 would require a national securities exchange or an exchange exempted from such registration based on limited volume, to file an amendment to revise its Form 1 within 10 calendar days after any material event takes place that renders inaccurate, or that causes to be incomplete:

(i) Any information filed on the Execution Page of revised Form 1, or an amendment thereto;

(ii) Any information filed as part of proposed Exhibits C (board), D (officers), E (executive board and committees), H (regulatory program), I (financial statements and information), J (financial information about subsidiaries and affiliates), K (general information about subsidiaries, affiliates, and SRO trading facilities), M (membership forms), N (financial responsibility requirements), O (listing applications), P (relationship among the exchange or association, any facility of the exchange or association, and any affiliate of either), S (list of members and participants), or U (location of books and records), and as part of Item 3 of Exhibit F (waivers of code of conduct and ethics) or Items 1, 5, 6 and 7 of Exhibit Q (certain information about ownership in a Disclosure Entity) to revised Form 1, or any amendments thereto; or

(iii) Any information filed as part of Items 2 and 3 of proposed Exhibit Q, or any amendment thereto, except that such information would not be required to be filed with respect to any ownership change that is less than 1% from the ownership interest last reported on Form 1, or any amendment thereto.[417]

[399] 17 CFR 240.6a–2(a).

[400] Currently, these exhibits are Exhibits C, F, G, H, J, K and M to Form 1. *See supra* note 289 for a brief description of the subject matter of the exhibits to current Form 1.

[401] 17 CFR 240.6a–2(b).

[402] Currently, these exhibits are Exhibits D, I, K, M, and N to Form 1. *See supra* note 289 for a brief description of the subject matter of the exhibits to current Form 1.

[403] 17 CFR 240.6a–2(c).

[404] Currently, these exhibits are Exhibits A, B, C, and J to Form 1. *See supra* note 289 for a brief description of the subject matter of the exhibits to current Form 1.

[405] *See supra* note 289 for a description of the information required by Exhibits A, B, C, J, K, M, and N.

[406] 17 CFR 240.6a–2(d).

[407] 17 CFR 240.15Aj–1.

[408] 17 CFR 249.801. Rule 15Aa–1 under the Exchange Act requires the initial filing of the Form X–15AA–1 for registration as a registered securities association or an affiliated securities association. *See* 17 CFR 240.15Aa–1.

[409] 17 CFR 240.15Aj–1(a).

[410] 17 CFR 259.802.

[411] 17 CFR 240.15Aj–1(b).

[412] 17 CFR 259.803.

[413] 17 240.15Aj–1(c)(i)–(ii).

[414] 17 CFR 240.15Aj–1(c)(2).

[415] 17 CFR 240.15Aj–1(c)(1)(i)–(ii). This alternative to paper filing is available for annual supplements and the filing of a complete Exhibit A to current Form X–15AJ–2, which is required every three years.

[416] Whereas proposed Rule 6a–2 resembles the current Rule 6a–2, proposed redesignated Rule 15Aa–2 would completely replace the text of the current Rule 15Aj–1 as a result of an effort to conform Rule 15Aa–2 more closely to Rule 6a–2 and thereby harmonize the procedural and timing requirements for the filing of the revised Form 1 and new Form 2 and any amendments.

[417] *See* proposed Rule 6a–2(a).

The Commission is proposing to retain the 10-day filing deadline requirement from the current Form 1, because the Commission believes that 10 days is a sufficient time period in which to file a Form 1 amendment.

The proposed amendments to redesignated Rule 15Aa–2 similarly would require a registered securities association or an affiliated securities association to file an amendment to revise new Form 2[418] within 10 calendar days after any material event takes place that renders inaccurate, or that causes to be incomplete: (i) Any information filed on the Execution Page of new Form 2, or an amendment thereto; (ii) any information filed as part of proposed Exhibits C (board), D (officers), E (executive board and committees), H (regulatory program), I (financial statements and information), J (financial information about subsidiaries and affiliates), K (general information about subsidiaries, affiliates, and SRO trading facilities), M (membership forms), N (financial responsibility requirements), O (listing applications), P (relationship among the exchange or association, any facility of the exchange or association, and any affiliates of either), S (list of members and participants), or U (location of books and records), and as part of Item 3 of Exhibit F (waivers of code of conduct and ethics) or Items 1, 5, 6 and 7 of Exhibit Q (certain information about ownership in a Disclosure Entity) to the new Form 2, or any amendment thereto; or (iii) any information filed as part of Items 2 and 3 of proposed Exhibit Q, or any amendment thereto, except that such information would not be required to be filed with respect to any ownership change that is less than 1% from the ownership interest last reported on Form 1 or Form 2, or any amendment thereto.[419]

The 10-day filing deadline requirement for filing an amendment to revised Form 1 is based on the current Form 1 filing deadline. The Commission believes that the filing requirements for exchanges and association should be uniform. As with the requirement for exchanges, the Commission believes that 10 days is a sufficient time period in which to file a Form 2 amendment.

Under proposed Rules 6a–2(b) and 15Aa–2(b), an exchange or association would be required to file an annual amendment to update the proposed revised Form 1 or new Form 2, as applicable, in its entirety, within 60 days of the end of its fiscal year. With respect to this annual amendment, the information would be required to be up-to-date as of the end of the latest fiscal year of the exchange or association.[420] The Commission believes that a 60-day filing deadline would give exchanges and associations sufficient time in which to file an annual amendment to Forms 1 and 2, while at the same time rendering the information contained in the annual amendment still timely and relevant.

The Commission believes that the proposed amendments to Rules 6a–2 and 15Aa–2 would enhance investor confidence in the integrity of the markets by requiring exchanges and associations to provide more consistent and up-to-date disclosures about significant changes in their governance, administration, regulatory programs, and ownership. Furthermore, by standardizing the requirements for exchanges and associations and by replacing the current forms for associations with new Form 2, the Commission believes the proposed rules should simplify and streamline the disclosure process and provide more uniform treatment for exchanges and associations. The Commission does not believe that the registration procedures for exchanges and associations under the Exchange Act should maintain differing disclosure requirements, as national securities exchanges and registered securities associations are charged with nearly identical obligations under the Exchange Act.[421]

The Commission also is proposing changes to the current requirements with respect to the format in which registration applications and their amendments are submitted, with the aim of making such information more readily accessible to both the Commission and the public. Currently, exchanges and associations submit their registration forms and amendments to the Commission, through its Division of Market Regulation, in paper format. As noted above, there are paper filing alternatives to the filing of exhibits to existing Form 1 and Forms X–15AJ–1 and X–15AJ–2.

Under proposed Rules 6a–2(c) and 15Aa–2(c), a national securities exchange, an exchange exempted from such registration based on limited volume, a registered securities association, or an affiliated securities association would be required to file the initial proposed revised Form 1 or new Form 2, and all subsequent amendments thereto (with a few exceptions),[422] in paper format with the Commission.[423] However, in addition to the paper filing, the Commission also proposes to require that each exchange and association continuously post its most recent annually amended registration form and any subsequent updating amendments on a publicly accessible Web site controlled by the exchange or association. In the Commission's view, a publicly accessible Internet Web site is one that does not require a password in order to access information contained in Form 1 or Form 2.

In addition, Rules 6a–2(c) and 15Aa–2(c) would require the exchange or association to indicate, in any amendments filed with the Commission, the location of the Internet Web site where the most recent Form 1 or Form 2 and any subsequent updating amendments may be found, and to certify that the information available at such location is accurate as of its date. The Commission believes that posting the most recent version of Form 1 or Form 2 on an Internet Web site would significantly increase transparency with regard to each exchange and association, and would assist the Commission, market participants, and the public in their understanding and awareness of significant aspects of these SROs.

Finally, the Commission proposes to add to Rules 6a–2 and 15Aa–2 a process for the Commission, upon written application or its own motion, to grant an exemption from the Form 1 or Form 2 filing requirements, either unconditionally or on specified terms and conditions, if the Commission determines that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors.[424] Currently,

[418] As part of the Commission's effort to simplify and streamline the disclosure process for registered securities associations and affiliated securities associations, new Form 2 would be used for all applications and amendments and would replace current Forms X–15AA–1, X–15AJ–1 and X–15AJ–2. *See supra* Section IV.F.

[419] *See* proposed Rule 15Aa–2(a).

[420] *See* proposed Rules 6a–2(b) and 15Aa–2(b).

[421] *See supra* Section I.A.

[422] The proposed rules provide an exception to the paper filing requirement for annual amendments to proposed Exhibits A, B, M, N, S, and T to revised Form 1 and new Form 2, and Items 1–7 of proposed Exhibit L to revised Form 1 and new Form 2. With respect to these Exhibits, an exchange or association, in lieu of filing such information in paper format, would only be required to identify the Internet web site it controls where such information is available continuously and to certify to the accuracy of such information as of its date. *See* proposed Rules 6a–2(d) and 15Aa–2(d).

[423] The Commission is not proposing at this time to require that exchanges and associations file revised Form 1 and new Form 2 electronically. In the future, the Commission may consider the feasibility of requiring electronic filing of revised Form 1 and new Form 2. *See, e.g.*, Securities Exchange Act Release No. 50486 (October 4, 2004), 69 FR 60287 (October 8, 2004) (adopting rules requiring SRO proposed rule changes under Section 19(b) of the Exchange Act, 15 U.S.C. 78s(b), to be filed electronically with the Commission).

[424] *See* proposed Rules 6a–2(e) and 15Aa–2(e).

Rule 6a–2 contains a provision providing procedures for the Commission, upon certain conditions, to exempt an exchange from filing an amendment required by the rule for any affiliate or subsidiary listed in Exhibit C to current Form 1. The Commission, however, proposes to include procedures for broader exemptive relief under Rules 6a–2 and 15Aa–2, particularly in light of the additional disclosure requirements that are proposed.

E. Proposed Changes to Rule 15Aa–1

Rule 15Aa–1 under the Exchange Act requires that an application for registration as a registered or an affiliated securities association shall be made on Form X–15AA–1.[425] Because the Commission is proposing to revise Form X–15AA–1 and redesignate it as new Form 2, the Commission is also proposing corresponding changes to Rule 15Aa–1. The amendment to Rule 15Aa–1 would clarify that an application for registration as a registered or an affiliated securities association shall be made on new Form 2.

F. Proposed Repeal of Forms X–15AJ–1 and X–15AJ–2

Currently, a registered securities association is required to file amendments or supplements to correct any statement that the association discovers is inaccurate or that is no longer accurate on Form X–15AJ–1.[426] An association also is required to file an annual consolidated supplement to its registration statement, and an amendment every three years with the Commission on Form X–15AJ–2.[427] Under the proposals, a registered securities association would be required to file all amendments to its registration application on new Form 2, rather than on Forms X–15AJ–1 or X–15AJ–2. Therefore, the Commission is proposing to repeal Forms X–15AJ–1 and X–15AJ–2. The Commission believes that the repeal of these forms should make the process of registration as a registered securities association or affiliated securities association, as well as the process of filing amendments to new Form 2, more efficient to the extent that associations could use one form for both purposes.

G. Request for Comment

The Commission seeks comments on the proposed changes to the forms for registration as a national securities exchange (or exemption from registration as a limited volume exchange) and as a registered securities association (or affiliated securities association), in addition to the companion rules governing the filing of the registration forms and amendments to those forms, as described above. In addition, the Commission requests that interested persons respond to the following specific questions:

Question 76. Are the requested disclosure items contained in revised Form 1 and new Form 2 appropriate? Are there other disclosure items that should be added or are there proposed items that should be deleted?

Question 77. Is the proposed definition of ''control'' in the proposed Instructions to revised Form 1 and new Form 2 appropriate?

Question 78. Is the proposed definition of ''disclosure entity'' in the proposed Instructions to revised Form 1 and new Form 2 appropriate?

Question 79. Is the proposed definition of ''immediate family member'' in the proposed Instructions to revised Form 1 and new Form 2 appropriate?

Question 80. Is the proposed definition of ''regulatory subsidiary'' in the proposed Instructions to revised Form 1 and new Form 2 appropriate?

Question 81. Is the proposed definition of ''SRO trading facility'' in the proposed Instructions to revised Form 1 and new Form 2 appropriate?

Question 82. Currently, national securities exchanges are required to provide more detailed disclosure to the Commission than are registered securities associations. The Commission's proposal aims to harmonize the filing requirements for exchanges and associations. Should registered securities associations be required to disclose the same items as national securities exchanges? Are any of the proposed disclosure items unnecessary for registered securities associations? Are there items that have not been proposed that should be added for registered securities associations? Is there any other information currently required by Form X–15AA–1 that should be retained in new Form 2?

Question 83. Are there features of the proposed disclosure requirements that should be applied to other SROs, such as registered clearing agencies and the Municipal Securities Rulemaking Board?

Question 84. Are the disclosure items contained in proposed Exhibit A (constitution, bylaws, rules) to revised Form 1 and new Form 2 appropriate? Are there other disclosure items that should be added or are there proposed items that should be deleted?

Question 85. Are the disclosure items contained in proposed Exhibit B (written rulings and interpretations) to revised Form 1 and new Form 2 appropriate? Are there other disclosure items that should be added or are there proposed items that should be deleted?

Question 86. Are the disclosure items contained in proposed Exhibit C (board) to revised Form 1 and new Form 2 appropriate? Are there other disclosure items that should be added or are there proposed items that should be deleted? Is it useful to require the disclosure of information relating to affiliations or relationships that reasonably could affect the director's independent judgment or decision-making for all directors?

Question 87. Are the disclosure items contained in proposed Exhibit D (officers) to revised Form 1 and new Form 2 appropriate? Are there other disclosure items that should be added or are there proposed items that should be deleted?

Question 88. Are the disclosure items contained in proposed Exhibit E (executive board and committees) to revised Form 1 and new Form 2 appropriate? Are there other disclosure items that should be added or are there proposed items that should be deleted? Is it useful to require disclosure of information relating to affiliations or relationships that reasonably could affect each executive board or committee member's independent judgment or decision-making? Is it useful to require the filing of the charters of each Standing Committee?

Question 89. Are the disclosure items contained in proposed Exhibit F (governance guidelines and codes of conduct) to revised Form 1 and new Form 2 appropriate? Are there other disclosure items that should be added or are there proposed items that should be deleted? Is it useful to require the disclosure of governance guidelines and codes of conduct and any waiver of the code of conduct?

Question 90. Are the disclosure items contained in proposed Exhibit G (organization charts) to revised Form 1 and new Form 2 appropriate? Would the organization charts be helpful? Should the Commission require a minimum level of detail that exchanges and associations should provide in the charts? Are there other disclosure items that should be added to this Exhibit?

Question 91. Are the disclosure items contained in proposed Exhibit H (regulatory program) to revised Form 1 and new Form 2 appropriate? Are there other disclosure items that should be

[425] 17 CFR 240.15Aa–1.

[426] 17 CFR 259.802. *See* Rule 15Aj–1(a) and (b), 17 CFR 240.15Aj–1(a) and (b).

[427] 17 CFR 259.803. *See* Rule 15Aj–1(c), 17 CFR 240.15Aj–1(c).

added or are there proposed items that should be deleted? Is it useful for SROs to disclose information about their regulatory programs, including the independence of the regulatory program from market operations and other commercial interests, any significant planned changes, and any significant issues and events and their effect on the regulatory program? Should SROs be required to submit copies of their delegations plans or other agreements pertaining to regulatory services provided by another SRO or its regulatory subsidiary, or the regulatory subsidiary of the applicant?

Question 92. Are the categories of financial disclosures contained in proposed Exhibit I (regulatory program financial and other information) appropriate? Are there any categories that need to be clarified, added, or deleted?

Question 93. Are the items in proposed Exhibit I pertaining to percentage of total budget and percentage of total revenues devoted to regulatory activities appropriate? Are there other items that should be included?

Question 94. Are the categories of revenues and expenditures and allocated costs in proposed Exhibit I that must be disclosed with respect to the regulatory program appropriate? Are there specific categories that should be added, deleted, or clarified? Do the specified items capture sufficiently the categories of revenue and expenses that exchanges and associations currently utilize? Would it be easy or difficult for SROs to provide the requested information?

Question 95. Should disclosure of a discussion of unusual events or significant economic changes that have had a material effect on the SRO's financial condition be required?

Question 96. Should disclosure of significant business developments involving the SRO be required?

Question 97. Should disclosure of material contracts and material related party transactions be required? Is the $60,000 threshold amount for material contracts and related party transactions, as set forth in proposed Exhibit I, appropriate? Should the threshold amount be set higher or lower?

Question 98. Should disclosure of material commitments for expenditures as of the end of the latest fiscal period and the purpose of those commitments and their anticipated source of funds be required?

Question 99. Should disclosure of charitable contributions in excess of $1,000, whether made directly or indirectly, under specified circumstances be required? Should the disclosure threshold be $1,000 or a higher or lower amount? Should all charitable contributions be disclosed? Are there other kinds of contributions that should be disclosed?

Question 100. Should disclosure of a table detailing the compensation of the five most highly compensated executives of the exchange or association, using Item 402(b) of Regulation S–K, be required?

Question 101. Should proposed Exhibit I require the disclosure of an annual report of the exchange's or association's Audit Committee?

Question 102. Are the disclosure items contained in proposed Exhibit J (subsidiary financial statements) to revised Form 1 and new Form 2 appropriate? Are there other disclosure items that should be added or are there proposed items that should be deleted?

Question 103. Are the disclosure items contained in proposed Exhibit K (SRO trading facility) to revised Form 1 and new Form 2 appropriate? Are there other disclosure items that should be added or are there proposed items that should be deleted?

Question 104. Are the disclosure items contained in proposed Exhibit L (SRO trading facility) to revised Form 1 and new Form 2 appropriate? Are there other disclosure items that should be added or are there proposed items that should be deleted?

Question 105. Are the disclosure items contained in proposed Exhibit M (membership forms) to revised Form 1 and new Form 2 appropriate? Are there other disclosure items that should be added or are there proposed items that should be deleted?

Question 106. Are the disclosure items contained in proposed Exhibit N (members' financial forms) to revised Form 1 and new Form 2 appropriate? Are there other disclosure items that should be added or are there proposed items that should be deleted?

Question 107. Are the disclosure items contained in proposed Exhibit O (listing forms) to revised Form 1 and new Form 2 appropriate? Are there other disclosure items that should be added or are there proposed items that should be deleted?

Question 108. Is the information proposed to be required in proposed Exhibit P (organizational charts) relating to the relationship between an exchange, an association, a facility of an exchange or association, and their respective affiliates, and whether and how the facility or affiliate has the power to influence or control the management, policies and regulatory responsibilities of the exchange or association, appropriate? Should the Commission require the exchange or association to provide any other information?

Question 109. Are the disclosure requirements contained in proposed Exhibit Q (ownership of an exchange or association or facility of an exchange or association) appropriate? Should the Commission require an exchange or association to disclose any additional information relating to such ownership?

Question 110. Should the Commission require the exchange or association to disclose direct and indirect ownership in any entity other than the exchange, association, or a facility of the exchange or association? If so, what other category of entity?

Question 111. In relation to the proposed ownership disclosure in proposed Exhibit Q, is the proposed definition of ''related persons'' appropriate? Should it be broader? Narrower?

Question 112. Will the exchange or association be able to obtain the information necessary to determine whether any person, alone or together with its related persons, exceeds the 5% reporting threshold? The Commission has proposed to require an exchange or association to have rules that would provide a mechanism for the exchange or association to obtain information from its owners or the owners of its facility regarding such ownership. Would this help? How difficult would it be for an exchange or association to implement such rules for owners that are not members, such as by amending its certificate of incorporation? Alternatively, should the Commission require an exchange or association to disclose ownership information only to the extent it is reasonably available to them, if they have made reasonable efforts to obtain such information and were unable to do so?

Question 113. Are the disclosure items contained in proposed Exhibit R (membership criteria) to revised Form 1 and new Form 2 appropriate? Are there other disclosure items that should be added or are there proposed items that should be deleted?

Question 114. Are the disclosure items contained in proposed Exhibit S (list of members) to revised Form 1 and new Form 2 appropriate? Are there other disclosure items that should be added or are there proposed items that should be deleted?

Question 115. Are the disclosure items contained in proposed Exhibit T (schedule of securities listed or admitted to trading) to revised Form 1 and new Form 2 appropriate? Are there other disclosure items that should be

added or are there proposed items that should be deleted?

Question 116. Is the requested disclosure item contained in proposed Exhibit U (location of books and records) of revised Form 1 and new Form 2 appropriate?

Question 117. Is the proposed change to Rule 17a–1 to require, for the existing five-year record retention period, an exchange or association (and other SROs) to maintain its books and records in the United States appropriate?

Question 118. In proposed Exhibit J to revised Form 1 and new Form 2, exchanges and associations would be required to provide separate annual financial statements for each affiliate. In proposed Exhibit K, exchanges and associations would be required to provide specified organizational information concerning each affiliate and for any unaffiliated entity that operates an SRO trading facility, including copies of organizational documents and lists of officers, governors, and Standing Committee members. Substantively, these requirements mirror those currently applicable to exchanges in Exhibits C and D of current Form 1. Given the trend toward SRO demutualization, and the prospect that an SRO could become part of a large conglomerate, should the SRO affiliates with respect to which information is required in proposed Exhibits J and K be narrowed (*e.g.* to those affiliates that are in the chain of control with the exchange or association, or to affiliates that are in the securities business)? If so, what specific information should be excluded with respect to these affiliates (*e.g.*, separate financial statements, copies of organizational documents)?

Question 119. Should the disclosure requirement contained in current Exhibit B to Form X–15AA–1 be retained in new Form 2 appropriate? Are there other disclosure items from Form X–15Aa–1 that should be added to revised Form 1?

Question 120. Are the revisions to proposed Rules 6a–2 and 15Aj–1 (to be redesignated as Rule 15Aa–2) appropriate? Is the 10-day filing deadline for periodic updates appropriate? Is it too long? Is it too short? Is the 60-day filing deadline for annual updates appropriate? Is it too long? Is it too short?

Question 121. The Commission has proposed to permit exchanges and associations, in complying with the requirement of filing amendments to revised Form 1 and new Form 2, to make proposed Exhibits A, B, M, N, S, or T or Items 1–7 of proposed Exhibit L available continuously on a Web site controlled by the exchange or association, instead of filing the information in the Exhibits in paper form. Should this Web site posting alternative be available for the filing other proposed Exhibits to revised Form 1 and new Form 2?

Question 122. Should there be more alternatives to paper filing, *e.g.*, simply relying on posting on the exchange's or association's Internet website?

Question 123. Should revised Form 1 and new Form 2 be integrated into a single form to be used both exchanges and associations?

Question 124. Should the Commission consider electronic filing of revised Form 1 and new Form 2, such as on EDGAR?

V. Periodic Reporting Obligations of Exchanges and Associations

A. Background and Need for Proposed Rule 17a–26

A critical component of the self-regulatory system is the Commission's authority to inspect and examine each SRO to ascertain whether it is properly complying with and enforcing federal statutory and regulatory provisions, as well as the SRO's own rules.[428] Among the mechanisms utilized by the Commission in its oversight efforts are cyclical inspections of SROs that concentrate on particular facets of their regulatory programs and targeted inspections of SROs that are conducted in response to particular developments. The periodic nature of the Commission's inspections of SROs, coupled with the inherent limitations on the Commission's ability to detect violations in a system based on self-regulation, creates a risk that the Commission could be unaware that an exchange or association may not be responding promptly and adequately to new regulatory issues, or may not be fully and promptly addressing the findings and recommendations of the Commission's staff's prior inspection. In addition, an issue uncovered during the course of an inspection of an exchange or association can foreshadow similar issues across several SROs in a particular regulatory program area. The Commission believes that its ability to identify such system-wide issues, given the time necessary for its staff to prepare for and conduct on-site inspections of one or more SROs, could be enhanced by its receiving regulatory program information from the SROs on a regular basis.

Accordingly, the Commission proposes to adopt new Rule 17a–26 under the Exchange Act to establish a system of quarterly and annual reporting by national securities exchanges and registered securities associations with respect to key aspects of their regulatory programs. Along with the proposals to strengthen the public disclosure requirements applicable to exchanges and associations,[429] proposed Rule 17a–26 is intended to enhance the Commission's ability to monitor exchanges' and associations' compliance with their regulatory responsibilities.

The proposed rule would elicit specific information about exchanges' and associations' regulatory programs, including their surveillance and disciplinary operations. By requiring exchanges and associations to file with the Commission the information specified in proposed Rule 17a–26 on a periodic basis, the Commission believes that it should be able to better target its on-site inspection resources and monitor more closely SROs' responses to critical issues affecting the securities markets, particularly during the period between Commission inspections of the exchange or association. Additionally, proposed Rule 17a–26 should assist the Commission in its efforts to stay abreast of new developments and challenges affecting SROs' self-regulatory obligations and to monitor SROs' performance of their statutory obligation to comply with, and enforce compliance with, the federal securities laws and the rules and regulations thereunder, in addition to the SROs' own rules. We believe that the information to be provided by SROs would be valuable to the Commission because it would highlight potential problem areas and, in turn, could aid the Commission in crafting an appropriate response. Accordingly, the information filed pursuant to the proposed rule could enhance the Commission's ability to oversee the SROs, their members, and the entities under their jurisdiction.

Furthermore, proposed Rule 17a–26 should improve compliance practices by SROs. In particular, the proposed rule

[428] The Commission has the authority to require exchanges and associations to make, keep, and file with the Commission any records, and make and disseminate any reports, that the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act. *See* Section 17(a)(1) of the Exchange Act, 15 U.S.C. 78q(a)(1).

In addition, all records of exchanges and associations are subject to such reasonable, periodic, special, or other examinations by representatives of the Commission as the Commission deems necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act. *See* Section 17(b)(1) of the Exchange Act, 15 U.S.C. 78q(b)(1).

[429] *See supra* Section IV.

would compel exchanges and associations to review, on a quarterly and annual basis, the operation and performance of their regulatory programs. In gathering the necessary information and preparing the required reports under the proposed rule, exchanges and associations would have the opportunity to review and assess the information that they compile and file with the Commission. The preparation of the reports required by proposed Rule 17a–26 should be particularly useful to the SRO's proposed Chief Regulatory Officer and the members of its proposed Regulatory Oversight Committee to inform them about the operations of the SRO's regulatory program. The reporting requirements should help exchanges and associations to identify potential weaknesses in their compliance practices and surveillance programs, and help facilitate their ability to quickly revise and, as necessary, strengthen their regulatory programs. Finally, by helping to bolster the effectiveness of self-regulation, proposed Rule 17a–26 should benefit not only the SROs and their members, but also users of their facilities and other market participants, as well as the investing public.

B. Scope and Timing of Reports Required by Proposed Rule 17a–26

Proposed Rule 17a–26 would require every exchange and association subject to the proposed rule [430] to file quarterly and annual reports with the Commission that contain specified information about their regulatory programs.[431] The information required by the proposed rule would concern the regulatory programs of an exchange or association (which would include any regulatory subsidiary)[432] and would encompass any surveillance, examination, and disciplinary programs. In the event that an exchange or association has entered into a contractual relationship with another SRO pursuant to which that SRO provides regulatory services to or on behalf of the exchange or association, the information required by the proposed rule also would need to account for the regulatory services provided on behalf of the exchange or association.

1. Quarterly Reports

Every national securities exchange and registered securities association subject to the proposed rule would be required to file with the Commission the reports specified in paragraph (b)(2) of proposed Rule 17a–26 on a quarterly basis, within 20 business days after the end of each calendar quarter.[433] The Commission believes that the requirement to file the quarterly reports within 20 business days after a quarter's end would accommodate the Commission's interest in receiving the reports as promptly as possible, while granting an exchange or association a sufficient amount of time to prepare and finalize the reports containing the information that it compiles during the course of the quarter. The scope of the information proposed to be required in the quarterly reports is discussed below.[434]

2. Annual Reports

Under proposed Rule 17a–26, every national securities exchange and registered securities association subject to the proposed rule also would be required to prepare an annual report covering the following categories of information: (1) An aggregated year-end cumulative summary of the information specified in the first seven items of the quarterly report provisions of the proposed rule,[435] (2) additional information on the SRO's regulatory program that is not required to be set forth in the quarterly reports, and (3) the annual report of an independent third party designed to assess whether the operations of any electronic SRO trading facility of the exchange or association comply with the rules governing such facility.[436] Together, these three categories, discussed below, would compose the annual report.[437] The proposed rule would specify that the annual report would have to be filed with the Commission within 60 calendar days after the calendar year end.[438] The Commission believes that the proposed requirement to file the annual report within 60 calendar days after the year's end satisfies the Commission's interest in receiving the reports as promptly as possible, while granting an exchange or association a sufficient amount of time to prepare the report. The scope of the information proposed to be required in the annual report in addition to the aggregated quarterly information is discussed below.[439]

C. Format of Reports

Proposed Rule 17a–26 would require all quarterly and annual reports, as well as all audits of electronic SRO trading facilities,[440] to be submitted electronically in a uniform, readily-accessible, and useable format.[441] To that end, the proposed rule would require every exchange and association subject to the proposed rule to establish procedures for the preparation of the quarterly and annual reports in a uniform, readily accessible, and usable electronic format, as well as to review those procedures from time to time to evaluate their efficacy, and to revise the procedures as necessary.[442] The reports should be in a user-friendly format, with an emphasis on readable layouts, ability to manipulate and search the data (including cutting, pasting, and exporting text), and a common,

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[430] Proposed Rule 17a–26 would not apply to a national securities exchange registered pursuant to Section 6(g)(1) of the Exchange Act, 15 U.S.C. 78f(g)(1), or to a national securities association registered pursuant to Section 15A(k)(1) of the Exchange Act, 15 U.S.C. 78o–3(k)(1). Because the Commission does not have primary responsibility for the regulation of entities under those provisions, including security futures product exchanges and limited purpose national securities associations, the Commission is proposing to exempt such exchanges and associations from Rule 17a–26. *See supra* note 77 (discussing the division of regulatory responsibility between the Commission and the CFTC).

[431] *See* proposed Rule 17a–26(a)(1) (regarding quarterly and annual reports) and (d) (regarding interim changes). Although proposed Rule 17a–26 would not expressly require exchanges or associations to maintain the records necessary to prepare the required reports, Rule 17a–1 under the Exchange Act, 17 CFR. 240–17a–1, would do so. Rule 17a–1(b) requires every exchange and association, among others, to keep and preserve all documents made or received by it in the course of its business for a period of not less than five years, the first two in an easily accessible place, subject to the destruction and disposition provisions of Rule 17a–6 under the Exchange Act, 17 CFR 240.17a–6.

[432] *See* proposed Rule 17a–26(j)(5) for a definition of the term ''regulatory subsidiary.''

[433] *See* proposed Rule 17a–26(a)(1).

[434] *See infra* Section V.D.

[435] *See* proposed Rule 17a–26(b)(2)(i)–(vii). Given the proposed electronic nature of the quarterly reports, the Commission would expect that it would be a relatively simple task for an SRO to aggregate the quarterly information and incorporate the data into the annual report. The Commission believes that the aggregation of this material in the annual report would facilitate its review by the SRO's management and governing board, including the Chief Regulatory Officer and the Regulatory Oversight Committee.

[436] *See* proposed Rule 17a–26(b)(3).

[437] Accordingly, at the end of a calendar year, the exchange or association would file the quarterly report for the fourth quarter within 20 business days after the end of the calendar year (which represents the end of the fourth quarter), and the annual report within 60 days after the calendar year end.

[438] *See* proposed Rule 17a–26(a)(1).

[439] *See infra* Sections V.E. and V.F.

[440] *See* proposed Rule 17a–26(a)(2).

[441] *See* proposed Rule 17a–26(b)(1)(ii). The term ''uniform'' in this context means that there should be uniformity in presentation of the data on the SRO's part for both quarterly and annual reports. *See also* Securities Act Release No. 8497 (September 27, 2004), 69 FR 59111 (October 1, 2004) (concept release regarding enhancing Commission filings through the use of tagged data). Data tagging uses standard definitions to translate text-based information into files that can be retrieved, searched, and analyzed through automated means.

[442] *See* proposed Rule 17a–26(b)(1)(ii).

compatible, and accessible program language. The proposed rule would not mandate a technology-specific format or a particular template for presenting the data, but it does contemplate that an exchange or association would select a commonly-acceptable standard that would emphasize presentation of the data in a simple layout with the ability to access and manipulate the data provided.

In proposing to require the exchanges and associations to establish procedures for preparing the data for quarterly and annual reports in an electronic format, the Commission hopes to minimize the costs incurred by exchanges and associations to generate the reports, and to foster a mutually acceptable format for the reports in a manner that facilitates historical comparisons and data tracking by each SRO and by the Commission. The Commission requests comment below on the nature of the proposed electronic format, as well as possible alternatives for a common format for all exchanges and associations that would be user-friendly and compatible with existing SRO and Commission computer systems. The Commission also seeks comment below concerning whether it should explore the feasibility of the filing of proposed quarterly and annual reports through a secure Web-based system.[443]

D. Quarterly Reporting of Regulatory Information

The categories of information specified below would compose the quarterly report required by the proposed rule. The program areas covered by these categories are designed to address the primary operations and main features of an exchange's or association's regulatory program, and constitute those areas for which the Commission has an interest in receiving information on a regular basis.

1. Information on the SRO's Surveillance Program

Proposed Rule 17a–26 would require exchanges and associations to report quarterly on the results of their surveillance programs, both manual and automated, during the reporting period.[444] This reported information would include, but would not be limited to, information on the number of exception reports and alerts generated, sorted by applicable rule or category.[445] An exchange or association also would be required to indicate the number of exception reports and alerts that were reviewed by the exchange or association and the number of exception reports and alerts that were referred for further investigation or for an enforcement proceeding.

The Commission believes that this information, as with the other categories of information required by the proposed rule, should better enable it to stay informed of novel and recurring issues that could present a challenge to an SRO's regulatory programs, as well as facilitate the Commission's ability to respond in a timely manner, as appropriate. The required information also should raise awareness of surveillance issues at the SROs, and allow the Commission and the SROs to take action when necessary to implement a coordinated response to any systemic concerns. Finally, the regular submission of this information should help focus the Commission's inspection resources on those matters that need urgent attention and encourage further cooperation between the Commission and each SRO in seeking solutions to regulatory challenges.

With respect to an exchange's or association's efforts to monitor for compliance with financial and operational requirements of its broker-dealer members, proposed Rule 17a–26 would require exchanges and associations to maintain records of and report information regarding all members that had net capital computation errors exceeding 10% of excess net capital, including an objective description of any action taken by the exchange or association in response to such deficiency.[446] An exchange or association also would be required to provide a list of members that were late in filing their FOCUS reports as well as a separate list of members that filed amended FOCUS reports, and provide an objective description of any response taken by the exchange or association in response to either of these situations.[447] The Commission believes that this information should allow it to better monitor the effectiveness of an exchange's or association's surveillance for compliance with net capital and FOCUS reporting obligations, and should permit the Commission to respond on a contemporaneous basis to circumstances that may warrant further attention.

Rather than identify the member firms by name, however, the proposed rule would require the lists to be prepared using a unique identifier specific to each member firm reported. Various provisions throughout the proposed rule, including the provision regarding compliance with financial and operational requirements, would require an exchange or association to assign each member firm (or its associated persons) a unique identifier for the purpose of reporting the information required by the proposed rule.[448] Although the exchange or association would not be required to include the identity of the member firm or its associated persons in the regularly-filed reports, a unique identifier would need to be used in a consistent manner in each quarterly and annual report in order to allow the Commission to spot trends involving a particular firm or individual. The protection afforded by a system of unique identifiers is intended to maintain the anonymity, with respect to the Commission, in information filed regularly with the Commission of the member firms or individuals subject to an investigation or regulatory action by an SRO. Commission staff could contact the SRO to follow-up if it saw a recurring pattern of a particular unique identifier being captured on the required reports.

2. Information on Complaints Received

Proposed Rule 17a–26 would require an exchange or association to report quarterly on all complaints it received during the reporting period that relate to the exchange's or association's regulatory programs.[449] An exchange or association would have to include objective summaries of the substance of

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[443] *See* Securities Act Release No. 50486, *supra* note 423.

[444] *See* proposed Rule 17a–26(b)(2)(i). Automated surveillance programs refer generally to computer-based programs that monitor activity for compliance with the SRO's rules and the federal securities laws and regulations, and generate alerts and reports upon the occurrence of any conduct that does not comply with designated parameters. Manual surveillance programs refer generally to non-computer-based regulatory review of activity.

[445] Exception reports and alerts are produced in connection with the operation of an SRO's manual and automated surveillance programs and generally highlight unusual activity that may be indicative of violations of the SRO's trading rules or the federal securities laws and regulations.

[446] See proposed Rule 17a–26(b)(2)(ii).

[447] *See id.* The Financial and Operational Combined Uniform Single Report (''FOCUS report'') is filed by a broker or dealer on Form X–17A–5 pursuant to Rule 17a–5(a), 17 CFR 240.17a–5(a). The FOCUS report is the basic financial and operations report required of brokers and dealers that are subject to minimum net capital requirements under Rule 15c3–1 of the Exchange Act, 17 CFR 240.15c3–15. An amended FOCUS report generally is filed when a broker or dealer becomes aware of a material inaccuracy in its previous filing.

[448] For example, Firm ABC could be identified according to the unique identifier ''MF123.'' Subsequent references to this member in the same or any subsequent reports would need to refer to the member as ''MF123.'' The unique identifier should be used consistently throughout a particular report, including across each category of information, as well as consistently in all reports over time.

[449] *See* proposed Rule 17a–26(b)(2)(iii).

each complaint received. The summaries would be grouped by the subject matter of the complaint, and would use a unique identifier specific to the member and any associated persons involved.[450] Similar to the requirements for financial and operational reporting, discussed above, the provision requiring information on complaints received would require an exchange or association to assign each member a unique identifier for the purpose of reporting the information required by the proposed rule.[451]

The summary also would need to include the type of source of the complaint (*e.g.,* ''member'' or ''public''), the date the complaint was received by the exchange or association, and the disposition of the matter, including an objective description of any action taken or response by the exchange or association and the date of any such response. By requiring SROs to file with the Commission information on complaints they receive, the Commission should be able to better monitor potential problem areas and take steps designed to ensure that the exchanges and associations are taking appropriate, timely action in response to complaints. In addition, the requirement to compile and summarize information on complaints should help to focus an SRO's attention on the complaints it receives and should facilitate its ability to assess any trends with respect to, and track the resolution of, such complaints.

3. Investigations, Examinations, and Enforcement Actions

The Commission proposes to require exchanges and associations to report on all investigations, examinations, and enforcement cases opened, closed, and pending during the reporting period. With respect to investigations, proposed Rule 17a–26 would require exchanges and associations to provide a summary of, including a count of the aggregate numbers of, open, closed, and pending investigations, as well as provide an objective summary of the facts and circumstances of each investigation.[452] The summary information would include, but would not be limited to, the member firm and any associated person(s) under review using a unique identifier specific to the member and any associated person(s);[453] a factual description of any alleged rule violations; a general identification of the type of source that led to the investigation (*e.g.,* ''member complaint'' or ''automated surveillance alert''); a factual description of the matter under investigation (*i.e.,* without subjective commentary, explanation, or elaboration by the exchange or association) and the relevant security symbol or type of security involved; the date of the occurrence of the matter under investigation and the date the alleged violation was reported or detected; the date the exchange or association opened the investigation; and the length of time the investigation has been open. For closed investigations, the summary also would include the date the investigation was closed; the length of time the investigation was open; and an objective description of the recommendations and disposition of the investigation. In addition, the proposed rule would require a summary of the number of investigations conducted during the reporting period as well as the average elapsed time, in days, for investigations closed during the reporting period.[454] This information should allow the Commission to better monitor the operations and effectiveness of the SROs' investigation programs, as well as spot trends with respect to potentially violative conduct by member firms and their associated persons.

With respect to examinations, proposed Rule 17a–26 would require exchanges and associations to provide a summary of, including a count of the aggregate numbers of, open, closed, and pending examinations, as well as provide an objective summary of the facts and circumstances of each investigation.[455] The summary information would include, but would not be limited to, the following: a list of the member firms examined, using a unique identifier specific to the member firm;[456] the member's examination cycle (*i.e.,* the frequency with which the member is generally examined, such as a one-year or two-year cycle); whether the examination was a routine cycle examination or whether it was for-cause and an objective description of any reasons for a cause examination; whether the examination was of a new member of the exchange or association and, if so, the date the new member registered under the Exchange Act and the date the examination of the new member commenced; an objective description of the scope and subject matter of the examination and the areas and items reviewed during the examination; the date the examination was opened and, as applicable, closed; the length of time the examination has been or was open; an objective description of any potential violations (*i.e.,* the rules allegedly violated); and a factual description of the recommendations and disposition of the examination.[457] In addition, we propose to require exchanges and associations to provide data on the number of examinations conducted during the reporting period and the average elapsed time, in days, for all examinations that have been completed during the reporting period.[458] As with the information proposed to be filed with the Commission regarding investigations, the Commission believes that its receipt of this information should permit it to better monitor each SRO's reasons for opening, and progress in conducting, examinations, and to discern trends across SROs.

Finally, with respect to enforcement cases, the Commission proposes to require exchanges and associations to provide a summary of, including a count of the aggregate numbers of, open, closed, and pending enforcement cases, as well as provide a factual summary of the facts and circumstances of each case.[459] The summaries would include a list of all enforcement cases, grouped by subject matter, and provide factual case information, including, but not limited to, the member firm and any associated person(s) under review, identified according to a unique identifier specific to the member firm and associated person;[460] the type of source that led to opening the case (*e.g.,* tip, referral from another regulator, complaint, etc.); a factual description of any alleged violations and the relevant security symbol or specific type of security involved; the date of occurrence of any alleged violations and the date they were reported or detected; the date the enforcement case was opened; and the number of days the

[450] *See supra* note 448 and accompanying text.

[451] *See supra* note 448 and accompanying text. To refer to an associated person of Firm ABC, an exchange or association could use a suffix system as follows: ''MF123–1.'' The unique identifier should be used consistently throughout a particular report, including across each category of information, as well as consistently in all reports over time.

[452] *See* proposed Rule 17a–26(b)(2)(iv).

[453] *See supra* note 448 and accompanying text. The unique identifier should be used consistently throughout a particular report, including across each category of information, as well as consistently in all reports over time.

[454] *See* proposed Rule 17a–26(b)(2)(iv).

[455] *See* proposed Rule 17a–26(b)(2)(v).

[456] *See supra* note 448 and accompanying text. The unique identifier should be used consistently throughout a particular report, including across each category of information, as well as consistently in all reports over time.

[457] *See* proposed Rule 17a–26(b)(2)(v).

[458] *See id.*

[459] *See* proposed Rule 17a–26(b)(2)(vi).

[460] *See supra* note 448 and accompanying text. The unique identifier should be used consistently throughout a particular report, including across each category of information, as well as consistently in all reports over time.

case has been open.[461] For cases closed during the reporting period, the exchange or association also would be required to provide the date the case was closed; the number of days the case had remained opened; and an objective description of the disposition of the case, including whether the case was settled and the sanctions imposed, if any, including any fines and penalties.[462] In addition, the report would include a summary of the number of enforcement cases conducted during the reporting period and the average elapsed time for all enforcement cases closed during the reporting period.[463] The Commission believes that the required information on enforcement cases could assist it in monitoring, on a regular basis, each exchange's and association's vigilance with respect to, as well as its resolution of, enforcement matters. In addition, this information should assist the Commission in its efforts to monitor developing enforcement issues that potentially could impact SROs generally, as well as focus an SRO's attention on trends in its enforcement program.

In the Commission's view, the proposed requirement to compile and summarize information on investigations, examinations, and enforcement actions should help to focus an SRO's attention on these regulatory activities and should facilitate the ability of its management, including its Chief Regulatory Officer and its Regulatory Oversight Committee, to monitor the SRO's vigilance in pursuing and completing investigations, examinations, and enforcement activity.

4. Information on Listings Programs

Under proposed Rule 17a–26, exchanges and associations would be required to provide quarterly information on their listings programs.[464] Each exchange or association would be required to provide information including a list of all securities that were newly listed and delisted during the reporting period; a list of all issuers to whom the exchange or association, or a facility thereof, sent during the reporting period a notice alleging that such issuer does not satisfy a rule or standard for continued listing on the exchange or association, or a facility thereof, and, in the case of an exchange, a notice that the exchange has submitted an application under Exchange Act Rule 12d2–2 (17 CFR 240.12d2–2) to the Commission to delist a class of the issuer's securities, and, in the case of an association, a notice that the association has taken all necessary steps under its rules to delist the security from its facility; a list of all issuers, using unique identifiers,[465] alleged to not satisfy a rule or standard for continued listing and any action taken with respect to any listed issuer that allegedly failed to satisfy any rule or standard for continued listing; and a list of any issuers, using unique identifiers, that are alleged to have failed to file timely quarterly or annual reports.[466] Further, the proposed rule would require exchanges and associations to set forth the rule or standard for continued listing that the issuer is alleged to have failed to satisfy and the date when the issuer was alleged to have failed to satisfy such rule or standard for continued listing. The summary also would need to discuss the status of any compliance plan agreed upon between the issuer and the exchange or association, including any alleged failure on the part of the issuer to satisfy any of the provisions of such compliance plan.[467] For listed options, the exchange or association would be required to provide information on any options classes or series that did not satisfy the applicable listing standards or rules when trading commenced.[468] The Commission believes that this information should permit it to better monitor, among other things, listing and delisting trends and, in particular, the SROs' handling of delisting proceedings.

5. Copies of Board and Committee Meeting Agenda

Proposed Rule 17a–26 would require every exchange and association to provide, as part of their quarterly reports, the final agenda from any meeting of the board of directors or executive committee of the exchange or association, or any meeting of any committee of the board of directors or executive committee, that occurs during the reporting period.[469] An exchange or association would not be required to resubmit this information as part of its annual report.[470] The Commission believes that the quarterly filing of this information would assist it in its efforts to keep abreast of regulatory matters considered by an exchange's or association's board and its committees and would help to focus the Commission's inspection efforts.

E. Annual Reporting of Regulatory Information

In addition to filing quarterly reports for each calendar quarter, proposed Rule 17a–26(b)(3) also would require an exchange or association to file an annual report with the Commission.[471] The annual report would contain a cumulative year-end summary of the first seven categories of information filed as part of the quarterly reports,[472] as well as an audit of any electronic SRO trading facility and a summary of several additional categories of regulatory information, and would be due within 60 calendar days after the year's end.[473] The additional categories of annual regulatory information are discussed below.

1. Cumulative Summary of Quarterly Information

The annual report required by proposed Rule 17a–26(b)(3) would need to contain an aggregated year-end cumulative summary of the information specified in the first seven items of the quarterly report provisions of the proposed rule.[474] Accordingly, the annual report would need to include a compilation of the following quarterly information: (1) The results of the surveillance programs; (2) the results of the surveillance programs for financial and operations requirements; (3) the summary of complaints relating to the exchange's or association's regulatory program; (4) the summary of investigations; (5) the summary of examinations; (6) the summary of enforcement cases; and (7) the summary of listings information. Exchanges and associations would not be required to re-file copies of their board and committee agenda. The Commission believes that the compilation and

[461] *See* proposed Rule 17a–26(b)(2)(vi).

[462] *See id.*

[463] The Commission anticipates that the provision of enforcement information under proposed Rule 17a–26 also would assist in the Commission's initiative to receive information pursuant to Rule 19d–1 under the Exchange Act, 17 CFR 240.19d–1, in electronic format.

[464] *See* proposed Rule 17a–26(b)(2)(vii). With respect to the proposed requirement to provide information on listing programs, for an exchange or association that has an affiliate that lists and trades securities, the exchange or association would be responsible for assuring that its affiliate provides it with the required information on its listings program, and the exchange or association would be responsible for including such information in its quarterly report.

[465] *See supra* note 448 and accompanying text. The unique identifier should be used consistently throughout a particular report, including across each category of information, as well as consistently in all reports over time.

[466] *See* proposed Rule 17a–26(b)(2)(vii).

[467] *See id.*

[468] *See id.*

[469] *See* proposed Rule 17a–26(b)(2)(viii).

[470] *See* proposed Rule 17a–26(b)(3).

[471] *See id.*

[472] *See* proposed Rule 17a–26(b)(2)(i)–(vii).

[473] *See* proposed Rule 17a–26(a)(1).

[474] *See* proposed Rule 17a–26(b)(2)(i)–(vii).

aggregation of the quarterly report information into the annual report should facilitate review of the annual report by the exchange's or association's management and board, including the proposed Chief Regulatory Officer and the proposed Regulatory Oversight Committee. Given the electronic nature of the quarterly reports, the Commission expects that an exchange or association should be able to compile the data easily. The Commission solicits comment, below, on this provision, including the attendant burden of aggregating the quarterly information into the annual report.

2. Processes for Carrying Out Regulatory Responsibilities

Proposed Rule 17a–26 would require exchanges and associations to report on their internal policies and procedures for carrying out their regulatory responsibilities on an annual basis.[475] Under this provision, the Commission proposes to require each exchange and association to describe in detail its overall program of surveillance for member compliance with all applicable rules, laws, and regulations. The purpose of this requirement, among other things, is for the SRO to report on its designated examining authority responsibilities, as well as on its manual and automated surveillance programs, including the processes for ensuring compliance by its members with the SRO's rules, as well as the federal securities laws and regulations. By requiring exchanges and associations to prepare and submit this information yearly, the Commission should be better apprised of each exchange's or association's regulatory programs and processes and how they contribute to the SRO's fulfillment of its statutory and regulatory obligations. In addition, by preparing this report, exchanges and associations should have a better opportunity to focus on the effectiveness of their regulatory programs and to ascertain whether revisions to those programs are necessary. The Commission notes that the annual report is intended to provide a greater depth of information than would be provided in Exhibit H of revised Form 1 and new Form 2[476] with respect to the exchange's or association's regulatory programs. The annual report also would need to highlight and summarize any new, revised, or terminated surveillance programs and discuss the reasons for such change.[477]

Each exchange and association would be required to identify the staff responsible for carrying out the SRO's regulatory and supervisory responsibilities by providing an organization chart detailing the various regulatory groups or divisions according to their areas of responsibility, and noting the names of staff and supervisors in each group or division.[478] This information is intended to provide the Commission with information about the organizational structure, and the lines of authority and areas of responsibility, with respect to the SRO's regulatory program.

3. Evaluation of the Regulatory Program

To complement the information provided by exchanges and associations pursuant to proposed Exhibit H of revised Form 1 and new Form 2, which would require exchanges and associations to describe generally their regulatory program and publicly disclose this information,[479] proposed Rule 17a–26 would require exchanges and associations to file with the Commission an evaluation of the effectiveness of their regulatory programs in effect during the reporting period.[480] An exchange or association would provide a discussion of the particular strengths and weaknesses of its regulatory program, as well as a discussion of any planned revisions to the regulatory program in response to any weaknesses, including those weaknesses uncovered during the process of preparing the quarterly and annual reports. In this regard, exchanges and associations would need to provide candid discussions of the overall operation and effectiveness of their regulatory programs, and would need to highlight the areas in which their programs should be improved. The Commission believes that this information should allow it to better monitor the operations of an SRO's regulatory program, with a particular emphasis on potential challenges to and weaknesses in an SRO's regulatory program. In addition, by preparing this information, SROs would be required to assess regularly the adequacy of their self-regulatory procedures and systems, and their ability to monitor properly the activity on their markets. The Commission also would expect this requirement to encourage closer cooperation between the Commission and the SROs in seeking solutions to regulatory challenges that SROs encounter.

4. Internal Controls

Under the proposed rule, an exchange or association would have to provide in the annual report a discussion of the internal controls implemented by the exchange or association that are designed to detect, prevent, and control any conflicts of interest between its market and other business interests and its self-regulatory responsibilities, and to assure that the exchange or association appropriately carries out its self-regulatory responsibilities.[481] The discussion would need to address the controls that assure the exchange or association adequately supervises its members, surveils for misconduct, and otherwise carries out its self-regulatory responsibilities even when the market operations and other commercial interests of the exchange or association create conflicting incentives.[482] The discussion also would need to address the controls that the exchange or association has in place that assures it carries out its self-regulatory obligations under the Exchange Act.[483] This provision is intended to assure that the exchange or association has the mechanisms in place to effectively control conflicts of interest arising from its business functions. The Commission expects exchanges and associations to remain acutely sensitive to the conflicts of interest that may arise between their commercial interests, including their facilities for the trading of securities, and their regulatory responsibilities. The periodic submission of information on the internal controls that address these conflicts should allow the Commission to better assess an SRO's ability to effectively carry out its regulatory obligations in the face of commercial pressures. Requiring an SRO to discuss its internal controls in the annual report also should help focus the SRO's attention on its internal controls and the operation of those controls.

[475] *See* proposed Rule 17a–26(b)(3)(i).

[476] *See supra* Section IV.C.6. (discussing proposed Exhibit H to revised Form 1 and new Form 2).

[477] Paragraph (d)(1) of proposed Rule 17a–26 would require exchanges and associations to file with the Commission a supplement in the event that the exchange or association implements, revises, or discontinues any manual or automated surveillance programs in the period between quarterly reports. The annual report should highlight and summarize any material reported pursuant to the interim changes provision, which is discussed in Section V.H. below.

[478] *See* proposed Rule 17a–26(b)(3)(i).

[479] *See supra* Section IV.C.6. (discussing proposed Exhibit H to revised Form 1 and new Form 2).

[480] *See* proposed Rule 17a–26(b)(3)(ii).

[481] *See* proposed Rule 17a–26(b)(3)(iii).

[482] *See id.*

[483] *See id.*

5. Employment Arrangements With Regulatory Personnel

Proposed Rule 17a–26 would require exchanges and associations to discuss the employment arrangements in effect between the exchange or association and its Chief Regulatory Officer and other senior regulatory program personnel.[484] The exchange or association would need to provide information on all aspects of its employment arrangements with its Chief Regulatory Officer and other senior regulatory program personnel, including salary and bonus levels and benefits and other cash and non-cash compensation paid to these individuals. This information would aid the Commission in its understanding and knowledge of the compensation arrangements for the most senior personnel at an exchange or association who are charged with carrying out the SRO's regulatory responsibilities.

6. Copies of Standing Committee Evaluations

Proposed Rule 17a–26 would require an exchange or association to file with the Commission copies of the most recent annual performance self-evaluation, as would be required by proposed Rules 6a–5 and 15Aa–3, of each Standing Committee of the board of a national securities exchange or registered securities association, as well as the proposed annual governance performance evaluation prepared by each exchange's or association's Governance Committee.[485] This information would allow the Commission to review each Standing Committee's assessment of its fulfillment of the responsibilities set forth in the committee's charter and an assessment of the overall governance of the exchange or association by its Governance Committee. The proposed responsibilities of the Standing Committees, as set forth in proposed Rules 6a–5 and 15Aa–3, generally are related to the self-regulatory functions of an exchange or association.

7. Compliance With Regulatory Plans

Under the proposed rule, exchanges and associations would be required to provide annual information on their efforts to comply with any recommendations resulting from any inspection or examination conducted by Commission staff.[486] Requiring exchanges and associations to provide periodic information on the status of their compliance with inspection recommendations should allow the Commission to respond more effectively to identified concerns and to monitor the implementation of recommended changes to an exchange's or association's regulatory program. Additionally, the proposed requirement should further encourage regular communication between exchanges and associations and the Commission's staff as a means to assist these SROs in tailoring and adjusting the implementation of the recommendations.

F. Audit Report of Electronic SRO Trading Facilities

Proposed Rule 17a–26 would require every exchange and association subject to the proposed rule that owns, operates, or sponsors an electronic SRO trading facility to file with the Commission, on an annual basis as part of the annual report, an audit report of an independent third party that assesses whether the operations of the electronic SRO trading facility comply with the rules governing the facility.[487] The purpose of the proposed requirement is to determine whether the facility's design and implementation is consistent with the exchange's or association's rules relating to such system that have been filed with and approved by the Commission.

For purposes of the proposed rule, an electronic SRO trading facility would be defined as a facility of an exchange or association that executes orders in securities on an electronic basis.[488] An independent third party would include a party not affiliated with the exchange or association that is qualified to render an opinion on such matters. We are not mandating the category of persons or entities that are qualified to perform such an audit and prepare the audit report with respect to an electronic SRO trading facility so that SROs would have flexibility in retaining an appropriate party to conduct their electronic SRO trading facility audit and prepare the audit report. At a minimum, however, the independent third party must have the capability to assess whether the system's design and implementation complies with the rules governing the facility. The Commission believes that the proposed requirement is a reasonable means to determine whether the systems aspects of electronic SRO trading facilities align with the rules that govern those facilities (*e.g.,* trading rules), particularly as electronic SRO trading facilities and their associated rules have become more complex over the years. This provision of the proposed rule is intended to evaluate the integrity of electronic SRO trading facilities with respect to compliance with applicable regulatory requirements and surveillance procedures.

G. Certifications

All quarterly and annual reports filed with the Commission pursuant to proposed Rule 17a–26 would be required to be accompanied by a signed certification executed on behalf of the exchange or association by the CEO or an equivalent officer, representing that the information contained in the report is current, true, and complete as of the date filed with the Commission.[489] Any supplemental filing submitted pursuant to proposed Rule 17a–26(d) also would need to be accompanied by a certification.[490] The Commission intends for the certification requirement to reinforce to exchanges and associations the importance of informing and updating the Commission on the operation of their regulatory programs and to remain mindful of their obligations as self-regulatory organizations.

H. Interim Changes

Proposed Rule 17a–26 would specify that any material changes to or material developments that effect an exchange's or association's regulatory program must be reported to the Commission in a supplemental filing within 10 business days after the occurrence of such event or change, along with a discussion of the event or change and the reasons for any change.[491] Examples of material changes that would require an exchange or association to file a supplement would include changes to the parameters of an exchange's or association's surveillance programs and any new, revised, or discontinued manual or automated surveillance programs that occurred since the filing of the previous quarterly report.[492] An exchange or association also would be required to report a material change to the organization or staffing of its regulatory or supervisory department or unit within 10 business days of such change.[493] The Commission believes that a 10 business day requirement

[484] *See* proposed Rule 17a–26(b)(3)(iv) and *supra* note 167 for a discussion of the term ''senior regulatory personnel.''

[485] *See* proposed Rule 17a–26(b)(3)(v). *See supra* Section II.B.3. for a discussion of proposed Rules 6a–5(f)(5), (g)(3), (h)(3), (i)(3), and (j)(6) and 15Aa–3, (f)(5), (g)(3), (h)(3), (i)(3), and (j)(6).

[486] *See* Rule 17a–26(b)(3)(vi).

[487] *See* proposed Rule 17a–26(a)(2).

[488] *See* proposed Rule 17a–26(j)(3).

[489] *See* proposed Rule 17a–26(c).

[490] *See id.*

[491] *See* proposed Rule 17a–26(d)(1).

[492] *See Id.*

[493] *See* proposed Rule 17a–26(d)(2).

strikes an appropriate balance between allowing the Commission to have prompt notice of material changes and giving an SRO adequate time to prepare and file a supplement with the Commission.

I. Confidentiality of Reports

An exchange or association could request confidential treatment of any report or other information that the exchange or association provides to the Commission pursuant to proposed Rule 17a–26.[494] The Commission would accord confidential treatment to the information to the extent permitted by law, including the Freedom of Information Act (''FOIA'').[495] An exchange or association would follow the procedures set forth in Rule 24b–2 under the Exchange Act to request confidential treatment of information filed pursuant to proposed Rule 17a–26.[496] With respect to the basis for requesting confidential treatment under FOIA, there are two exemptions that likely would be relevant to a Commission determination whether to grant confidential treatment for information filed with the Commission under proposed Rule 17a–26. First, FOIA Exemption 8 provides an exemption for matters that are ''contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions.''[497] Similarly, Commission Rule 80(b)(8), implementing FOIA Exemption 8, states that the Commission generally will not publish or make available to any person matters that are ''[c]ontained in, or related to, any examination, operating, or condition report prepared by, on behalf of, or for the use of, the Commission, any other Federal, state, local, or foreign governmental authority or foreign securities authority, or any securities industry self-regulatory organization, responsible for the regulation or supervision of financial institutions.''[498] The information required by proposed Rule 17a–26 is material that would be submitted by SROs to their primary regulator in connection with and to facilitate the Commission's periodic inspections of exchanges and associations, and would supplement the Commission's examination and inspection program.[499]

Second, FOIA Exemption 4 provides an exemption for ''trade secrets and commercial or financial information obtained from a person and privileged or confidential.''[500] Commission Rule 80(b)(4)(iii), which implements FOIA Exemption 4, provides that this exemption is available for ''information contained in reports, summaries, analyses * * * arising out of, in anticipation of or in connection with an examination or inspection of the books and records of any person or any other investigation.''[501] The information to be filed with the Commission pursuant to the proposed rule concerns regulatory and supervisory processes of SROs, and may contain trade secrets and commercial information, such as information involving the proprietary design of an exchange's or association's surveillance systems.

J. Compliance Date

The first quarterly report required by proposed Rule 17a–26 would be due for the first full quarterly reporting period commencing six months after the publication of any final rule in the **Federal Register**.[502] The Commission believes that this implementation period would allow exchanges and associations sufficient time to begin tracking, to the extent they are not currently doing so, all categories of information required by the proposed rule, as well as to develop an electronic format for filing the proposed reports.

K. Exemptions and Extensions of Time for Filing Reports

Under Rule 17a–26 as proposed, the Commission would consider granting an extension of time for the filing of any reports or materials required by the proposed rule, upon the written request of an exchange or association or upon its own motion, if it determines that such extension is necessary or appropriate in the public interest and is consistent with the protection of investors.[503] In addition, upon the written request of the exchange or association or on its own motion, the Commission would consider granting an exemption from any of the proposed rule's requirements, either unconditionally or on specified terms and conditions, if it determines that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors.[504] The proposed rule also would exempt from its reporting requirements all notice-registered exchanges and limited purpose securities associations.[505]

L. Filing of Reports

Each report required by Proposed Rule 17a–26 shall constitute a ''report'' within the meaning of the Exchange Act, including the books and records provision of Sections 17(a) and the liability provisions of Sections 18(a) and 32(a).[506] In proposing this provision of the proposed rule, the Commission intends to specify that the reports submitted pursuant to proposed Rule 17a–26 would be subject to the general books and requirements of the Exchange Act and would be subject to the Exchange Act's provisions governing liability for misleading statements in reports filed with the Commission.

M. Request for Comment

The Commission invites interested persons to submit written comments on proposed Rule 17a–26. The Commission specifically requests comments on the following aspects of the proposed rule:

Question 125. Is the proposed rule sufficiently clear regarding the information that is proposed to be required to be filed in the quarterly and annual reports? Are there any categories of information that should be added or deleted?

Question 126. Are there provisions of the proposed rule that would be difficult for an exchange or association to satisfy and, if so, how could the provision in question be better tailored to assist in compliance?

Question 127. Are the time frames for providing quarterly reports, *i.e.*, within 20 business days after the calendar quarter end, and annual reports, *i.e.*, within 60 days after the year end, appropriate? Should they be shorter, *e.g.*, 10 business days after the end of the calendar quarter end for the

[494] *See* proposed Rule 17a–26(e).

[495] *See* 5 U.S.C. 552.

[496] *See* 17 CFR 240.24b–2.

[497] 5 U.S.C. 552(b)(8).

[498] 17 CFR 200.80(b)(8).

[499] *See* Section 17(b)(1) of the Exchange Act, 15 U.S.C. 78q(b)(1) (providing that all records of exchanges and associations are subject to such reasonable, periodic, special, or other examinations by representatives of the Commission as the Commission deems necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act).

[500] 5 U.S.C. 552(b)(4).

[501] 17 CFR 200.80(b)(4)(iii).

[502] *See* proposed Rule 17a–26(f).

[503] *See* proposed Rule 17a–26(g).

[504] *See* proposed Rule 17a–26(h)(1).

[505] *See* proposed Rule 17a–26(h)(2). *See also* 15 U.S.C. 78f(g) (notice-registered exchanges) and 78*o*–3(k)(1) (limited purpose securities associations).

[506] *See* proposed Rule 17a–26(i). *See also* 15 U.S.C. 78q(a) (Section 17(a) under the Exchange Act requiring the maintenance of certain books and records); 78r(a) (Section 18(a) under the Exchange Act providing for liability for misleading statements); and 78ff(a) (Section 32(a) under the Exchange Act providing for penalties for willful violations and false and misleading statements).

quarterly report, or longer, *e.g.*, 75 or 90 days after the year's end for the annual report?

Question 128. Should the quarterly and annual reports required by the proposed rule be based on the SRO's fiscal year, rather than on a calendar year basis? Are there reporting requirements in the proposed rule that should be filed on a fiscal year basis?

Question 129. Should the Commission require a fourth quarter report to be filed 20 business days after the calendar year end, given the requirement to file an annual report 60 days after the year end and the fact that the annual report would contain, in an aggregated form, information from the fourth quarter? If the Commission decides to require filing of only the first three quarterly reports, how could the information for the fourth quarter be separated in the annual report? Should it be separated in the annual report?

Question 130. Are there issues presented by requiring the report of an annual independent audit to assess the operations of an exchange's or association's electronic SRO trading facility for compliance with all applicable SRO rules and with the federal securities laws and regulations? Are there other ways for the Commission to achieve the same result, *i.e.*, to determine that the operation of any electronic SRO trading facility is conducted in accordance with all applicable statutory provisions and rules? Does the proposal provide sufficient time for the independent audit report to be prepared and incorporated into the annual report? If not, what time period would be sufficient? Should the audits be required more or less often? Should the Commission establish specific criteria to determine the entities qualified to conduct such an audit and prepare a report? Should the audit be required to be conducted by an independent auditor? Would independent public auditor be capable of conducting such audits? How much would such an audit cost?

Question 131. Are any issues presented by the Commission's proposed requirement that exchanges and associations establish procedures for the preparation of the quarterly and annual reports in a uniform, readily accessible, and usable electronic format? Should the Commission mandate the use of a particular format? Should the Commission require exchanges and associations to work together to develop a plan for filing the required reports in a standard electronic format? What role should the Commission play in such a process?

Question 132. If the Commission were to adopt a technological standard for the format of the electronic quarterly and annual reports, what standard would be appropriate? The Commission's primary concern in considering a technological standard is to minimize costs to the exchanges and associations, allow for easy manipulation and use of the data submitted, and not unduly restrict the development and adoption of new technological standards and formats. What standard or method would best serve to accomplish these goals? To what extent should the electronic reports be in a Microsoft Excel-type format versus a XML ''data tagging'' language format? If data tagging is the better approach, would XML, or a variation thereof, be an appropriate standard? To what extent does the appropriate electronic format depend upon the type and amount of data that would be required under the proposed rule?

Question 133. Should the Commission specify a method by which exchanges and associations file the proposed information, such as CD-ROM? Should the Commission explore the creation of a secure Web-based system for the filing of the required reports?

Question 134. Would the requirement that the annual report contain an aggregation of the quarterly information for a given year be a relatively simple task, given the electronic nature of the reports? Would the inclusion of aggregated quarterly data in the annual report be helpful to an SRO's management, including its Chief Regulatory Officer and the Regulatory Oversight Committee, in reviewing the operation of the SRO's regulatory program on an annual basis? What arguments are there against requiring the annual report to contain the aggregated quarterly data?

Question 135. Are there any items that should be added or deleted with respect to the results of surveillance programs, both manual and automated, and the results of surveillance for financial and operational requirements? Should the Commission require more or less detail on some or all of the items? Are there any alternatives to unique identifiers that could better accomplish the goals of tracking the information over time without including the identity of the member? Are there any issues presented by requiring the unique identifiers to be constant over time?

Question 136. Are there any items that should be added or deleted in connection with the summaries of complaints, investigations, examinations, and enforcement cases? Should the Commission require more or less detail on any of the subcategories mentioned under any of those items? Should the Commission require information on other categories of complaints? Are there any alternatives to unique identifiers that could better accomplish the goals of tracking the information over time without including the identity of the member and associated person under review? Are there any issues presented by requiring the unique identifiers to be constant over time?

Question 137. Is the provision requiring reporting of listings activity, including reporting of securities that were delisted or otherwise reprimanded for failure to satisfy listing standards, appropriate? Should the listings information in the proposed quarterly reports be expanded to include information on SRO delisting decisions that were appealed during the reporting period? Should the summary contain additional information on compliance plans? Is there any other information that should be added or deleted from this provision?

Question 138. Is the provision requiring an exchange or association to file with the Commission, as part of the quarterly report, copies of agenda for board and committee meetings appropriate? Should the Commission require the filing of the complete minutes for board and committee meetings, or, as an alternative, some specified portion of the minutes? If a specified portion were required, what should that portion include? Should the provision extend to subject matter committees that are not composed of directors and are not part of the official board committee structure?

Question 139. Is the requirement that the annual report contain a discussion of the internal policies and procedures an exchange or association uses to carry out its regulatory responsibilities appropriate? Are there any items under this category that should be deleted or added?

Question 140. Is the requirement that the annual report contain an organizational chart of the regulatory department appropriate? Should the Commission require more or less detail to be reported on this chart? Should the Commission require contact information and employee titles to be reported in the chart? Should the Commission limit or expand the categories of staff that need to be specifically identified in the chart?

Question 141. Is the provision requiring the SRO to evaluate the effectiveness of its regulatory program, including strengths and weaknesses, appropriate? Are there other

requirements that should be included in or deleted from this provision?

Question 142. Is the requirement that the annual report contain a discussion of the internal controls regarding conflicts of interest appropriate? Are there items that should be added or deleted from this provision?

Question 143. Is the requirement that the annual report discuss the employment arrangements with the Chief Regulatory Officer appropriate? Is requiring a discussion of employment arrangements with senior regulatory program personnel appropriate? Should the Commission limit the coverage of this provision to the five most highly compensated regulatory personnel? If so, is five the appropriate number or should the number be higher or lower?

Question 144. Is the requirement that the annual report contain a copy of the annual performance self-evaluation prepared by a national securities exchange's or registered securities association's standing committees, including its Nominating, Compensation, Audit, and Regulatory Oversight Committees, appropriate? Is the requirement to provide a copy of the annual performance evaluation prepared by the Governance Committee appropriate?

Question 145. Is the requirement to discuss efforts to comply with any recommendations or plan resulting from a Commission inspection or examination appropriate?

Question 146. Is the certification requirement appropriate? Is the chief executive officer the appropriate official to certify the quarterly and annual reports on behalf of the exchange or association? In light of the provision of proposed Rules 6a–5 and 15Aa–3, which would require exchanges and associations to establish a Chief Regulatory Officer, would it be more appropriate for the Chief Regulatory Officer to certify the required reports, or for both officers to certify?

Question 147. Under the Commission's current rules, if an SRO wanted to request confidential treatment for information filed pursuant to proposed Rule 17a–26, the SRO would need to submit a request for confidential treatment pursuant to Rule 24b–2, and follow that Rule's procedures. As discussed above, each SRO subject to proposed Rule 17a–26 would be required to submit quarterly and annual reports. In light of the regularity of filing of the proposed reports, should the Commission adopt a confidential treatment request procedure like Rule 83? If the Commission adopts a procedure like Rule 83, are there ways that the Rule 83 procedure should be tailored in the context of Rule 17a–26? If so, how?

Question 148. Are the provisions relating to the reporting of interim changes to the regulatory program and regulatory department or unit appropriate? Are there any other interim changes or developments, in addition to the changes to surveillance programs and changes to the exchange's or association's regulatory department cited in the rule, that should specifically be mentioned as triggering an obligation to file a supplement with the Commission?

Question 149. Are the defined terms appropriate and sufficiently clear? Is the definition of the term ''electronic SRO trading facility'' and ''regulatory subsidiary'' appropriate? Should the Commission add to, delete, or modify any of the defined terms in the proposed rule?

VI. Proposed Rule 17a–27

A. Background and Need for Proposed Rule 17a–27

Proposed Rule 17a–27 would require a member of a national securities exchange or registered securities association that is a broker or dealer to provide notice to the Commission and the exchange or association of which it is a member when it acquires more than a 5% ownership interest in such exchange, association or in a facility of such exchange or association through which it is permitted to effect transactions. The proposed rule is designed to facilitate the ability of the Commission and each exchange and association to monitor the accumulation of significant ownership interests by members, so as to help ensure that exchanges and associations effectively perform their regulatory obligations to oversee the operations of their members and trading in their own markets, and to further the ability of the Commission to carry out its regulatory oversight of exchange and associations. This reporting requirement also is designed to complement proposed Rules 6a–5(o) and 15Aa–3(o), which would require exchanges and associations to have rules that prohibit their members that are brokers or dealers from owning and voting more than 20% of the exchange or association or a facility of the exchange or association, and proposed Items 2 and 3 of Exhibit Q to revised Form 1 and new Form 2, which would require an exchange or association to provide to the Commission information on all persons that own more than 5% of the exchange or a facility of the exchange or association.[507]

B. Description of Proposed Rule 17a–27

1. Brokers and Dealers Subject to the Rule

Proposed Rule 17a–27 would require any member[508] of an exchange or association that is a broker or dealer to file a statement with the Commission if such member, alone or together with its related persons, acquires, directly or indirectly, beneficial ownership[509] of more than 5% of any class of securities or other ownership interest in a disclosure entity.[510] For purposes of proposed Rule 17a–27, the term ''disclosure entity'' would be defined to mean, with respect to a member, an exchange or association of which it is a member, or a facility of an exchange or association through which it is permitted to effect transactions.[511] The term ''related persons'' would be defined in proposed Rule 17a–27(a)(13) to cover the same relationships as the term ''related persons'' in proposed Rules 6a–5 and 15Aa–3.[512] As discussed above in Section II, the Commission believes it is important to capture all

[507] *See supra* Sections II.B.9. and IV.C.9. for a detailed discussion of these proposed rules.

[508] ''Member'' would be defined to have the meaning in Section 3(a)(3) of the Exchange Act, 15 U.S.C. 78c(a)(3). *See* proposed Rule 17a–27(a)(9).

[509] ''Beneficial ownership'' would be defined to have the meaning in Rule 13d–3 under the Exchange Act, 17 CFR 240.13d–3, as if (and whether or not) such security or other ownership interest were a voting equity security registered under Section 12 of the Act; *provided that,* to the extent any person beneficially owns any security or other ownership interest solely because such person is a member of a group within the meaning of Section 13(d)(3) of the Exchange Act, such person would not be deemed to beneficially own such security or other ownership interest for purposes of this section, unless such person had the power to direct the vote of such security or other ownership interest. *See* proposed Rule 17a–27(a)(3) and *supra* note 226.

[510] *See* proposed Rule 17a–27(b)(1). Proposed Rule 17a–27(c) also would require the member to provide a copy of the statement to the exchange or association, as applicable.

[511] *See* proposed Rule 17a–27(a)(6). The term ''disclosure entity'' would exclude exchanges registered under Section 6(g) of the Exchange Act, 15 U.S.C. 78f(g), and national securities associations registered under Section 15A(k) of the Exchange Act, 15 U.S.C. 78*o*–3(k). Because the Commission does not have primary responsibility for regulating these exchanges and associations, members of such exchanges and associations would not be subject to proposed Rule 17a–27. *See supra* note 77.

[512] *See* proposed Rules 6a–5(b)(19) and 15Aa–3(b)(20). ''Person'' would be defined to have the meaning in Section 3(a)(9) of the Exchange Act, 15 U.S.C. 78c(a)(9). *See* proposed Rule 17a–27(a)(11). Members can be natural persons. If a member is a natural person, and a broker or dealer, it would be subject to the proposed Rule. If the member is not a broker or dealer, the member's affiliated broker or dealer (which would be subject to the rule) would be required to aggregate the member's interest with its own interest.

potential relationships of a member with another person that could lead to the member having the ability to influence or control an exchange or association.[513]

2. Information Required To Be Filed

Any statement required to be filed by a member pursuant to proposed Rule 17a–27 would be required to include the following information:[514]

- The title of the class of securities or other ownership interests for which the member is required to file the statement, and the identity and form of organization of the disclosure entity;[515] and
- Such member's contact information, principal occupation (if the member is a natural person), and principal business (if the member is not a natural person).[516]

The member would be required to provide general information regarding the ownership interest that is the subject of the filing, including: (i) The total number of securities or other ownership interests of the disclosure entity issued and outstanding in each class or series; (ii) if the securities are publicly traded, the market(s) where they trade; (iii) any restrictions on ownership voting, transfers, or other disposition of such securities or other ownership interest of the disclosure entity; and (iv) any other material provisions relating to ownership of the disclosure entity.[517] In addition, the member would be required to state whether the disclosure entity is a reporting issuer under Section 12 of the Exchange Act.[518]

The member also would be required to state the aggregate number and percentage of shares of a class of securities or other ownership interest of the disclosure entity that are beneficially owned by the member.[519] In addition, the member would be required to indicate the aggregate number of shares or other ownership interest as to which the member has sole power to vote or to direct the vote, shared power to vote or to direct the vote, sole power to dispose or to direct the disposition, or shared power to dispose or to direct the disposition.[520] Also, if any other person is known to have the right to receive or the power to direct the receipt of dividends from, or the proceeds from the sale of, such securities or other ownership interest, the member would be required to include a statement to that effect and, if such interest relates to more than 5% of the securities or ownership interest, to identify such person.[521] Further, the member would be required to separately identify each related person whose ownership in a disclosure entity is included in the calculation of beneficial ownership required to be disclosed by the member, and provide the same ownership information for the related person as for the member.[522] As noted above in Section IV, these requirements are modeled on the information required to be included in Schedule 13D or 13G under the Exchange Act.[523] The Commission believes these requirements are appropriate because the intent of proposed Rule 17a–27—to provide the Commission with up-to-date information on the ability of members to control or influence the exchange—is similar to the purpose of the disclosure requirements of Sections 13(d) and 13(g) of the Exchange Act and the rules thereunder.[524]

The member also would be required to describe the power or ability of the member and its related persons to direct or cause the direction of the management and policies of the disclosure entity and any ability to exercise any influence or control over the regulatory responsibilities of the exchange or association.[525] In addition, the member would be required to describe any contracts, arrangements, understandings or relationships (legal or otherwise) among the member and its related persons and between such persons and any other person with respect to any securities or other ownership interest of the disclosure entity, including but not limited to the transfer or voting of any of the securities or ownership interest, finder's fees, joint ventures, loan or option arrangements, put or calls, guarantees of profits, division of profits or loss, or the giving or withholding of proxies. Such disclosure also would be required with respect to any of the securities or other ownership interests that are pledged or otherwise subject to a contingency the occurrence of which would give another person voting power or investment power over such securities or interest, except the statement would not need to disclose any standard default or similar provisions contained in loan agreements. The member would be required to provide the names of the other parties to these contracts, arrangements, understanding or relationships.[526]

Each statement filed by a member pursuant to this proposed rule would constitute a ''report'' within the meaning of Sections 17(a), 18(a), and 32(a) of the Exchange Act, and any other applicable provisions of the Exchange Act.[527] In addition, each statement required to be filed by a member pursuant to proposed Rule 17a–27 would be considered filed upon receipt by the Division of Market Regulation at the Commission's principal office in Washington, D.C.[528]

The disclosure requirements of proposed Rule 17a–27 are designed to provide information on members' significant interests in their regulators or a facility thereof. The Commission believes that this information would further the ability of the exchange or association to carry out its regulatory responsibilities with respect to its members, and for the Commission to perform its statutory oversight of the exchange or association, by helping to reduce the potential for conflict between a member and its regulator.

3. Timing of Filing

A member would be required to make its initial filing of a statement under Rule 17a–27 within 10 calendar days of when it, together with its related persons, beneficially owns more than 5% of any class of securities or other ownership interest, as set forth in paragraph (b)(1) of the proposed rule.[529] In addition, a member would be required to file an amendment to the statement within ten calendar days of any change in the information required to be provided. However, a member would not be required to amend its statement if there is an increase or decrease of less than 1% of the ownership interest last reported on the statement or any amendment thereto.[530]

[513] *See supra* Section II.B.9. for a discussion of the proposed definition of related persons.

[514] *See* proposed Rule 17a–27(b)(2).

[515] *See* proposed Rule 17a–27(b)(2)(i).

[516] *See* proposed Rule 17a–27(b)(2)(ii) and (iii).

[517] *See* proposed Rule 17a–27(b)(2)(iv).

[518] 15 U.S.C. 78*l*. *See* proposed Rule 17a–27(b)(2)(v).

[519] *See* proposed Rule 17a–27(b)(2)(vi)(A). For purposes of making this percentage determination, a class of securities means the outstanding securities of such class, exclusive of any securities of such class held by or for the account of the disclosure entity (the issuer), or a subsidiary of the disclosure entity. *See* proposed Rule 17a–27(a)(4).

[520] *See* proposed Rule 17a–27(b)(2)(vi)(B).

[521] *See* proposed Rule 17a–27(b)(2)(vi)(C). A listing of the shareholders of an investment company registered under the Investment Company Act of 1940 or the beneficiaries of an employee benefit plan, pension fund or endowment fund would not be required.

[522] *See* proposed Rule 17a–27(b)(2)(vii) and *supra* notes 519–521 and accompanying text.

[523] *See supra* Section IV.C.9.

[524] 15 U.S.C. 78m(d) and (g).

[525] *See* proposed Rules 17a–27(b)(2)(viii) and 17a–27(b)(2)(ix).

[526] *See* proposed Rule 17a–27(b)(2)(x).

[527] 15 U.S.C. 78q(a), 78r(a), and 78ff(a). *See* proposed Rule 17a–27(e)(i).

[528] *See* proposed Rule 17a–27(e)(ii).

[529] *See* proposed Rule 17a–27(b)(3).

[530] *See* proposed Rule 17a–27(b)(4).

The Commission believes the 10 day time period is reasonable in that it provides for timely disclosure by the member while still providing sufficient time to make and prepare the filing.

4. Filings With the Exchange or Association

A member also would be required to provide a copy of the statement and all amendments to the applicable exchange or association,[531] and the exchange or association would be required to post a copy of the statement on its publicly-accessible Web site within 10 calendar days of receipt.[532]

5. Exemptions

Finally, paragraph (f) of proposed Rule 17a–27 would provide a process for the Commission, upon written request or its own motion, to grant an exemption from the provisions of the proposed rule, either unconditionally or on specified terms and conditions, if the Commission determines that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors. Pursuant to this provision, the Commission would consider and act upon appropriate requests for relief from the rule's provisions and consider the particular facts and circumstances relevant to each such request, the potential ramifications of granting any exemption, and any appropriate conditions to be imposed as part of the exemption.

C. Request for Comment

The Commission seeks general comments on all aspects of proposed Rule 17a–27 as described above. In addition, the Commission requests that interested persons respond to the following specific questions:

Question 150. Would the information the Commission proposes to require members to provide to the Commission and the applicable SRO further SROs' ability to carry out their regulatory obligations? Would the information be useful to investors?

Question 151. Is the definition of beneficial ownership appropriate? Is it too narrow? Or is it too broad?

Question 152. Is the proposed definition of ''related persons'' too narrow? Too broad? Is there any other relationship that should be included?

Question 153. Should any person associated with a member be included in the proposed definition of ''related person,'' or should only those associated persons that possess, directly or indirectly, the power to direct or cause the direction of management and policies of the member, whether through the ownership of voting securities, by contract, or otherwise be included within the definition of ''related person''?

Question 154. Are the categories of information that would be required on the statement pursuant to proposed Rule 17a–27 appropriate? Are there other categories that should be included, or some that should be deleted?

Question 155. Should the Commission require members to provide any information in addition to what is proposed? If so, what additional information should be required?

Question 156. Is 10 days sufficient time for members to make the initial filing, or do commenters think that less time is necessary? Or is more than 10 days needed?

Question 157. Is 10 days sufficient time for members to update information previously filed, or do commenters think that less time is necessary? Or is more than 10 days needed?

Question 158. Is the proposed exclusion of members' ownership in notice registered national securities exchanges and limited purpose national securities associations from the scope of proposed Rule 17a–27 appropriate? If not, why should they be included?

Question 159. The proposal would only require members that are broker-dealers to file statements under Rule 17a–27; it would not require members that are natural persons and not registered as broker-dealers to file such statements. The Commission asks for comment on whether all members should be subject directly to the proposed reporting requirement.

Question 160. Should the Commission require that members provide the required information in a particular form? For instance, should the Commission create a standardized form to be used to file the reports required by proposed Rule 17a–27? If so, please provide detail as to the structure of such a form.

Question 161. Should the Commission apply the proposed rule to those persons that are not statutory ''members'' but that own one or more memberships, or ''seats,'' in an exchange, but are not registered brokers or dealers and do not trade on or through the facilities of the exchange, but lease the trading right to a broker-dealer? If so, should it depend upon whether the person retains the voting rights associated with such membership?

Question 162. Will members have access to, or the ability to obtain for each item, information that would be required to be filed pursuant to proposed Rule 17a–27? In particular, would a member be able to obtain the information required by paragraph (b)(2)(iv) on the total number of securities or other ownership interest issued and outstanding of a disclosure entity? Is there any information a member would not be able to easily obtain?

VII. Implementation

The Commission is proposing to implement the proposed rules and rule amendments and proposed revisions to forms as follows:

Proposed Rules 6a–5 and 15Aa–3 would require SROs to file proposed rule changes that comply with the applicable proposed rule's requirements no later than four months following the date of publication in the **Federal Register** of any governance rules adopted by the Commission, and would require that SROs have final rules approved by the Commission no later than ten months following such publication date. The SROs' rule changes would have to be operative no later than one year following the publication date of any governance rules adopted by the Commission.

Regulation AL would be operative one year following the date of publication in the **Federal Register** of the adoption of proposed Regulation AL.

Revised Form 1 and new Form 2 would become effective 30 days following the date of publication in the **Federal Register** of the adoption of the proposed amendments to these forms in the case of those applicants whose registration forms have not yet been approved by the Commission as of such publication date. The proposed amendments to Rules 6a–2 and 15Aa–2 also would become effective 30 days following the date of publication in the **Federal Register** of the adoption of these proposed amendments in the case of those applicants whose registration forms have not yet been approved by the Commission.

Pursuant to proposed paragraph (g) of Rule 6a–2 and proposed paragraph (f) to Rule 15Aa–2, any exchange or association that is registered with the Commission as of the publication date of the adoption of proposed amendments to these Commission rules would be required to file a complete new statement together with all exhibits no later than six months following such publication date. Until such filing, currently-registered exchanges and associations could continue to rely on the requirements of the current registration forms and the related rules.

[531] *See* proposed Rule 17a–27(c).

[532] *See* proposed Rule 17a–27(d).

The amendment to Rule 17a–1 would become effective 30 days following the date of publication in the **Federal Register** of the adoption of proposed amendments to Rule 17a–1.

Under proposed Rule 17a–26, the first quarterly report would be due for the first full quarterly reporting period commencing six months following the date of publication in the **Federal Register** of the adoption of proposed Rule 17a–26.

Finally, proposed Rule 17a–27 would become effective 60 days following the date of publication in the **Federal Register** of the adoption of proposed Rule 17a–27.

We request comment on these proposed implementation dates and whether they would provide sufficient time for SROs to comply with the proposed new rules and rule amendments and the proposed revisions to the forms. We request comment on whether more or less time is necessary for exchanges and associations to review their governance and regulatory structures in light of the proposed governance rules and whether the proposed implementation schedule would provide sufficient time for the SROs to prepare proposed rule changes, prepare for necessary governance changes, and conform to the requirements relating to the independence of the regulatory programs from market operations and other commercial interests.

We also seek comment on the feasibility of existing exchanges and associations preparing a complete new registration statement within the proposed six month time frame. We further recognize that many of the proposals are interrelated and thus some requirements cannot be complied with until all rule and form revisions are fully implemented, *e.g.*, certain revised Form 1 and new Form 2 Exhibits relate to items proposed in the governance rules. Accordingly, we request commenters' views on an implementation schedule that would achieve the Commission's goal of having any final rules become operative as soon as feasible, yet provide exchanges and associations with sufficient time to comply with any new requirements.

VIII. General Request for Comment

The Commission seeks comment on proposed Exchange Act Rules 3b–19, 6a–5, 15Aa–3, 17a–26, and 17a–27; proposed amendments to current Exchange Act Rules 6a–2, 15Aa–1, 15Aa–2 (redesignated Rule 15Aj–1), and 17a–1; proposed Regulation AL; proposed amendments to Form 1 and to Form 2 (redesignated Form X–15AA–1); and the proposed removal of Forms X–15AJ–1 and X–15AJ–2.

We ask commenters to address whether the proposed rules are appropriately tailored to achieve the goal of furthering sound governance as well as the other applicable provisions of the Exchange Act by requiring SROs' boards to be composed of a majority of independent directors and Standing Committees to be fully independent and by mandating the independence of the SROs' regulatory functions from their market operations and other commercial interests. We also request comments on the need to, and appropriateness of, requiring exchanges and associations to limit the ability of their members that are brokers or dealers from owning or voting a significant stake in the exchange or association (or facility thereof), to reduce conflicts of interest and the potential for a member to influence or control its regulator in a manner detrimental to its competitors or in a manner favorable to such member. In addition, we seek commenters' views regarding the proposal to enhance the transparency of SROs' governance and ownership structures and regulatory activities and its potential impact on users of the SROs' trading facilities, other market participants, and the public generally. Further, we seek comment on the proposed disclosure items of revised Form 1 and new Form 2, and the timing and form of amendments to proposed Rules 6a–2, 15Aa–1, and 15Aa–2. We specifically request comment on the ability of an exchange or association to obtain the ownership information necessary to comply with the ownership disclosure requirements of revised Form 1 and new Form 2.

We ask commenters to address Rule 17a–26, including whether there are items of information that should be added or deleted in the quarterly and annual reports to the Commission. We also specifically request comment on the effectiveness of proposed Regulation AL to enhance an exchange's or association's monitoring of listing and trading of affiliated securities and thus to reduce the potential conflicts inherent in such oversight, and whether proposed Regulation AL would provide adequate guidance for preparing and filing the required quarterly and annual reports. We also seek comment on the usefulness of the disclosures required by proposed Rule 17a–27. We request comment on whether proposed Rule 17a–27 is too broad or narrow in its reach and whether the Commission should prescribe a form for providing such disclosures. We also seek comment on the various proposed definitions and the proposed numerical criteria and threshold values that are contained in the proposed rules. We seek comments on the proposals as a whole, including their interaction with each other, and whether they would achieve their intended goals.

Commenters should, when possible, provide us with empirical data to support their views. Commenters suggesting alternative approaches should provide comprehensive proposals, including any conditions or limitations that they believe should apply. The Commission also invites commenters to provide views and data concerning the costs and benefits associated with the proposed new rules and amendments to existing rules and forms.

International Commenters

The Commission shares the goal of the international regulatory community in seeking greater convergence of robust standards for oversight of the securities markets, and recognizes that the proposals described above would impact foreign exchanges seeking to conduct business directly in the U.S. market. Accordingly, we are interested in obtaining comment from foreign exchanges and market participants about these proposals. We are interested in general comments, and, specifically, the extent to which any of the proposals would cause conflicts with foreign law. In assessing the comments, the Commission will be mindful of the importance of its investor protection mandate and the need for a level playing field.

We specifically request comment on the following topics:

Question 163. With regard to the Governance Standards Proposal, are there any direct conflicts of law in your jurisdiction? Has your jurisdiction had recent experience with the issues raised by this proposal? If so, please describe the approach taken in your jurisdiction.

Question 164. With regard to the Transparency Proposal, are there any direct conflicts of law in your jurisdiction? Has your jurisdiction had recent experience with the issues raised by this proposal? Please describe the types of reporting requirements to which exchanges in your jurisdiction are subject.

Question 165. With regard to the SRO Reporting Proposal, are there any direct conflicts of law in your jurisdiction, in particular with regard to privacy laws? Has your jurisdiction had recent experience with the issues raised by this proposal? If so, please describe the approach taken in your jurisdiction.

Question 166. With regard to the SRO Ownership Proposal, are there any direct conflicts of law in your jurisdiction? Has your jurisdiction had recent experience with the issues raised by this proposal? If so, please describe the approach taken in your jurisdiction.

IX. Paperwork Reduction Act Analysis

A. Proposed Rule 3b–19

The proposed amendments to Rule 3b–19 under the Exchange Act do not impose recordkeeping or information collection requirements, or other collections of information that require approval of the Office of Management and Budget (''OMB'') under 44 U.S.C. 3501, *et seq.* Accordingly, the Paperwork Reduction Act does not apply.

B. Proposed Amendments to Rule 6a–2, Revised Form 1, Rule 15Aa–2, and New Form 2

Proposed Rule 6a–2, revised Form 1, proposed Rule 15Aa–2, and new Form 2 contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 (''PRA'').[533] The Commission has submitted them to the OMB for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title for the collection of information with respect to exchanges is ''Form 1 and Rules 6a–1 and 6a–2: Form of Application and Amendments.'' The collection of information contains a currently approved collection of information under OMB control number 3235–0017. The title for the new collection of information with respect to associations is ''Form 2 and Rules 15Aa–1 and 15Aa–2: Form of Application and Amendments.'' OMB has not yet assigned a control number for the new collection of information contained in proposed Rules 15Aa–1 and 15Aa–2 and new Form 2. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.[534]

1. Summary of Collections of Information

The Commission proposes to require that an applicant for registration as a national securities exchange, or an exemption from exchange registration based on limited volume, file Form 1, as proposed to be revised. An applicant for registration as a securities association or an affiliated securities association would be required to file Form 2 (formerly Form X–15AA–1), as proposed to be revised.[535] Proposed Rule 6a–2 would require national securities exchanges to submit annual amendments and certain interim updating amendments to their registration application on the revised Form 1. Proposed Rule 15Aa–2 would require registered associations to submit annual amendments and certain interim updating amendments to their registration application on the new Form 2. The Commission also proposes to repeal Forms X–15AJ–1 and X–15AJ–2, which are now used by associations to file amendments to Form X–15AA–1.

The proposals would require an exchange or association to disclose more detailed information about its governance, regulatory functions, and ownership in its registration form and amendments thereto. The current Form 1 Exhibits that would be incorporated in revised Form 1 and new Form 2 require the following information:

- Copies of the applicant's constitution or articles of incorporation, by-laws, and rules (Exhibit A);
- Written rulings, settled practices and interpretations of the applicant (Exhibit B);
- Information about officers (current Exhibit J, proposed Exhibit D);
- Audited financial statements (Exhibit I);
- Separate financial statements for each affiliate of the applicant (current Exhibit D, proposed Exhibit J);
- General information about the applicant's affiliates and any unaffiliated entity that operates an SRO trading facility (current Exhibit C, proposed Exhibit K);
- A description of the manner of operation of any SRO trading facility used to effect transactions on the applicant (current Exhibit E, proposed Exhibit L);
- A complete set of all forms pertaining to application for membership, participation or subscription to the applicant, application for approval as a person associated with a member, participant, or subscriber, and any other similar materials (current Exhibit F, proposed Exhibit M);
- A complete set of all forms of financial statements, reports or questionnaires required of members, participants, subscribers, or any other users relating to financial responsibility or minimum capital requirements (current Exhibit G, proposed Exhibit N);
- A complete set of documents comprising listing applications (current Exhibit H, proposed Exhibit O);
- A description of the criteria for membership, conditions leading to suspension or termination of membership, and any procedures for suspension or termination (current Exhibit L, proposed Exhibit R); and
- A list of all members, participants, subscribers or other users and general information about such person (current Exhibit M, proposed Exhibit S).

The proposed additional Exhibits to the revised Form 1 and new Form 2 would require enhanced disclosures of exchanges and associations, as follows:

- A description of the composition, structure, and responsibilities of the applicant's board of directors and information about its Chairman and/or Chief Executive Officer (Exhibit C);
- A description of the structure, composition and responsibilities of any executive board and committee of the applicant and a complete governance chart of the applicant (Exhibit E);
- Copies of the applicant's governance guidelines and code of conduct and ethics (and a disclosure of any waivers of the code) (Exhibit F);
- An organizational chart illustrating the internal governance structure of the applicant and indicating each department or division and their respective responsibilities (Exhibit G);
- A description of the applicant's regulatory program, including its independence from the other functions of the applicant, any significant planned changes in the applicant's regulatory program, and any significant regulatory issues or events that may affect the applicant's regulatory program and a copy of any delegation plans or other contracts relating to regulatory services to be provided to the applicant (Exhibit H);
- A detailed description of the applicant's financial activities, including an itemization of the applicant's revenues and expenses derived from the applicant's regulatory activities, an itemization of non-regulatory expenses, a discussion of information necessary to an understanding of the financial condition of the applicant and any material changes in its financial condition, a discussion of any unusual or infrequent events or transactions or any significant economic changes that have had a material effect on the financial condition of the applicant and any known demands, commitments, events or uncertainties that would result in or are reasonably likely to result in a

[533] 44 U.S.C. 3501, *et seq.*

[534] 44 U.S.C. 3512.

[535] The Commission also proposes to amend Rule 15Aa–1 under the Exchange Act, 17 CFR 240.15Aa–1, to state that associations would file an initial application for registration on new Form 2. This is a technical change that would not impose recordkeeping or information collection requirements, or other collections of information within the meaning of the PRA.

material change in financial condition, a description of any significant business development involving the applicant, a description of all material contracts and all material related party transactions, a description of material commitments by the applicant for expenditures as of the end of the latest fiscal period, certain charitable contributions of the applicant in excess of $1,000, a table detailing the compensation (and the material terms of the employment agreements) of the five most highly compensated executives of the applicant, and a description of the compensation provided to directors (Exhibit I);

- An organizational chart of the relationship between the applicant, any facility of the applicant, and any affiliate of the applicant or a facility of the applicant, and information about the nature and ownership structure of those entities (Exhibit P);
- Enhanced disclosures of the ownership interest of any applicant or facility (''disclosure entity''), and information on any person and its ''Related Persons'' that directly or indirectly beneficially owns more than 5% of any class of securities or other ownership interest in a disclosure entity (Exhibit Q);
- The location of where the applicant's books and records are maintained (Exhibit U); and
- A schedule of listed securities and securities admitted to unlisted trading privileges, including information about the ''self-listing'' of the applicant, an SRO trading facility of the applicant, or any affiliate of the applicant or of an SRO trading facility of the applicant (current Exhibit N, proposed Exhibit T).

The proposals further would require exchanges and associations to submit any amendments to revised Form 1 or new Form 2 on a basis more frequent than is currently required. Proposed Rules 6a–2 and 15Aa–2 under the Exchange Act would require a national securities exchange, an exchange exempted from such registration as a national securities exchange based on limited volume, a national securities association, or an affiliated securities association to file an amendment to the revised Form 1 or new Form 2 (as applicable) within 10 calendar days after any material event takes place that renders inaccurate, or that causes to be incomplete: (i) Any information filed on the Execution Page of proposed Form 1 or new Form 2, or an amendment thereto; (ii) any information filed as part of proposed Exhibits C, D, E, H, I, J, K, M, N, O, P, S or U and as part of Item 3 of Exhibit F or Items 1, 5, 6, and 7 of Exhibit Q to the proposed Form 1 or new Form 2, or any amendments thereto; [536] and (iii) information filed as part of Items 2 or 3 of Exhibit Q, or any amendment thereto, except that such information is not required to be filed with respect to any person whose ownership change is less than 1% from the ownership interest last reported on the revised Form 1 or new Form 2, or any amendment thereto.[537]

An exchange or association also would be required to file an annual amendment to update revised Form 1 or new Form 2 (as applicable) in its entirety within 60 days of the end of its fiscal year. With respect to this annual amendment, each Exhibit would be required to be up to date as of the end of the latest fiscal year of the exchange or association.[538] An exchange or association also would be required to post continuously any amendments required to be filed under proposed Rules 6a–2(a)–(b) and 15Aa–2(a)–(b) on a publicly accessible Internet Web site, simultaneous with the filing of such information in paper form with the Commission.[539]

In addition, exchanges and associations that are registered with the Commission as of the date of publication in the **Federal Register** of adoption of the proposed amendments to the forms would be subject to a one-time requirement to file a complete revised Form 1 or new Form 2, as applicable, no later than six months following such publication date.

2. Proposed Use of Information

The purpose of the collections of information in proposed Rules 6a–2 and 15Aa–2, revised Form 1, and new Form 2 is to keep the Commission, market participants, and the public informed of the governance and ownership structure and regulatory program of each applicant and harmonize the procedures for application as a national securities exchange and as a registered securities association and for the submission of amendment to such applications. The information required to be disclosed should enable the Commission, market participants, and the public to gain a greater awareness of key features of the exchange's or association's governance and ownership structure and its regulatory programs. The disclosure items on the revenues and expenditures of the SRO's regulatory programs should be particularly useful to the Commission, market participants, and the public.[540] Further, the information collected should significantly enhance the transparency of each applicant's organizational and ownership structure and regulatory programs and assist the Commission in monitoring each applicant's compliance with the governance requirements contained in proposed Rules 6a–5 and 15Aa–3 under the Exchange Act.

[536] *See* proposed Rules 6a–2(a)(1)–(2) and 15Aa–2(a)(1)–(2). The referenced Exhibits would solicit the following information: (1) Information regarding the composition, structure, and responsibilities of the Board (Exhibit C); (2) information with respect to the officers (Exhibit D); (3) information regarding the structure, composition, and responsibilities of the executive board and each committee (Exhibit E); (4) information regarding the regulatory program (Exhibit H); (5) audited financial statements (Exhibit I); (6) separate financial statements, including a balance sheet and an income statement and statement of cash flows (Exhibit J); (7) information regarding each affiliate of the applicant and any unaffiliated entity that operates an SRO trading facility (Exhibit K); (8) the forms pertaining to the application for membership, participation, or subscription (Exhibit M); (9) the forms of financial statements, reports, or questionnaires required of members, participants, subscribers, or any other users relating to financial responsibility or minimum capital requirements (Exhibit N); (10) documents comprising the applicant's listing applications, including any agreements required to be executed in connection with listing and a schedule of listing fees (Exhibit O); (11) information on exchanges, associations, their facilities, and their respective affiliates (Exhibit P); (12) list of members, participants, subscribers, or other users and general information about each (Exhibit S); (13) location of books and records (Exhibit U); (14) disclosure of any waivers of the code of conduct and ethics for directors or officers (Item 3 of Exhibit F); or (15) information about each class or series of outstanding securities or other ownership interest of an exchange, association, or facility of either; whether and how each person and Related Person possess the power to influence the management or policies of the exchange, association or facility; if a Disclosure Entity is a partnership, a list of partners that have the right to or have contributed more than 5% of the partnership's capital; and contracts, arrangements, understandings or relationships between such persons, and between such persons and any other person with respect to any securities or other ownership interest of the Disclosure Entity (Items 1, 5, 6, and 7 of Exhibit Q).

[537] *See* proposed Rules 6a–2(a)(3) and 15Aa–2(a)(3). Items 2 and 3 of Exhibit Q would require the following information: (1) General information about any person who alone or together with its Related Persons, directly or indirectly beneficially owns more than 5% of any class of securities or other ownership interest in a Disclosure Entity (Item 2 of Exhibit Q); and (2) information regarding each Related Person identified above whose ownership in a Disclosure Entity is included in the calculation of beneficial ownership and the number and percentage of shares of ownership interest of such security that are beneficially owned (Item 3 of Exhibit Q). *See* proposed Exhibit Q of revised Form 1 and new Form 2.

[538] *See* proposed Rules 6a–2(b) and 15Aa–2(b).

[539] *See* proposed Rules 6a–2(c) and 15Aa–2(c). Pursuant to Rule 6a–2(d), however, an exchange would not be required to file amendments under paragraphs (a) or (b) of proposed Rule 6a–2 with respect to Exhibits A, B, M, N, S, or T or Items 1–7 of Exhibit L in paper form, as long as the exchange or association makes such information continuously available on an Internet Web site under its control, indicates the location of the Web site where such information could be found, and certifies that the information available at such location is accurate as of its date.

[540] *See* Sections 6(b)(1) and 15A(b)(2) of the Exchange Act, 15 U.S.C. 78f(b)(1) and 78*o*–3(b)(2).

3. Respondents

The collection of information in Rule 6a–1, proposed Rule 6a–2, and revised Form 1 would apply to every registered national securities exchange and every exchange exempt from registration as a national securities exchange based on limited volume. Currently, there are nine registered securities exchanges.[541] The collection of information in Rule 15Aa–1, proposed Rules 15Aa–2, and new Form 2 would apply to every national securities association and every affiliated securities association. Currently, there is one national securities association.[542]

4. Reporting and Recordkeeping Burden

Based on the information available to the Commission at this time, the Commission estimates that an applicant for registration as a national securities exchange, a securities association, or an affiliated securities association, or for an exemption from registration as a national securities exchange based on limited volume would incur an average burden of 157 hours to obtain information necessary to, and to prepare, each initial Form 1 or Form 2 application, respectively. The Commission estimates that the additional information required in Form 1, as proposed to be revised, would impose an additional paperwork burden of 110 hours on an applicant, for a total recordkeeping and reporting burden of 157 hours per applicant.[543] Proposed Form 2 would be a completely new form, and therefore does not have an existing ''collection of information'' burden within the meaning of the PRA.[544] However, because new Form 2 would impose the same paperwork burden on association applicants that revised Form 1 would impose on exchange applicants, the Commission estimates that the paperwork burden for Form 2 also would be 157 hours per applicant. Those exchanges and associations that are registered with the Commission as of the publication date of adoption of the proposed revisions to the forms would be subject to a one-time requirement to file a complete new registration statement on Form 1 or Form 2, as applicable, within six months following such publication date, and thus they also would have an initial paperwork burden of 157 hours each. The Commission estimates that any registered exchange or association, whose fiscal year ends after the date by which the one-time complete new registration statement on revised Form 1 or new Form 2, as applicable, would be required to be filed, but within the same calendar year that such one-time filing is required, would incur an additional reporting and recordkeeping burden of 20 hours for the first year to prepare an annual amendment to the revised Form 1 or new Form 2, as applicable.

In addition, the Commission estimates that an applicant will incur a yearly burden of 40 hours to comply with the requirement in proposed Rules 6a–2 and 15Aa–2 to file annual and periodic amendments to revised Form 1 or new Form 2. This figure represents a 15 hour increase from the current Form 1 average burden due to the estimated additional burden of the annual reporting requirements.[545]

Proposed Rules 6a–2 and 15Aa–2 also would require exchanges and associations to post their amendments on a publicly accessible Internet Web site. The Commission notes that exchanges and associations currently are required to maintain a publicly accessible Web site.[546] The Commission estimates that an exchange or association would incur a paperwork burden of 4 hours to post its amendment on a publicly available Web site,[547] and that the exchange or association would post an average of two amendments per year, for a total burden of 8 hours annually per exchange or association. The Commission requests comment on its estimate of the average number of amendments an SRO would file per year, as well as on its estimate of how long it would take an exchange or association to post an amendment on its Web site. The Commission also requests comment as to whether an SRO would incur any start-up costs in preparation for compliance with this Internet posting requirement under proposed Rules 6a–2 and 15Aa–2.

An applicant also would incur costs in the mailing of paper filings and copies to the Commission. The Commission estimates that the costs of mailing an initial application on revised Form 1 or new Form 2 would be $673.33.[548] The costs of filing a complete registration form on revised Form 1 or new Form 2 no later than six months following the final rules publication date is also estimated by the Commission to be $673.33.[549] The Commission estimates that the costs of mailing an amendment to revised Form 1 or new Form 2 would be $365.86.[550]

The Commission estimates that total reporting and recordkeeping burden for an exchange that submits an initial registration or exemption application on the revised Form 1 would be 157 hours and $673.33 per applicant.[551] For exchanges that are already registered with the Commission, the estimated reporting and recordkeeping burden for filing a complete revised Form 1 and any requisite updating amendments for the first year in which the final rules' are published would be 177 hours and approximately $1,039 per exchange. Thus, the Commission estimates that the total recordkeeping and reporting burden for all nine registered exchanges for the first year in which the final rules are published would be 1,593 hours and approximately $9,351. After the year in which an exchange initially files the revised Form 1, the Commission estimates that such exchange would bear an annual reporting and recordkeeping burden of 48 hours and $731.72, and that all exchanges would bear a total annual reporting and recordkeeping burden of 432 hours and approximately $6,585.

The Commission estimates that total reporting and recordkeeping burden for

[541] These nine registered national securities exchanges are the Amex, BSE, CHX, CBOE, ISE, NSX, NYSE, PCX, and the Phlx. The collection of information does not apply to national securities exchanges registered under Section 6(g) of the Exchange Act and limited purpose securities associations registered under Section 15(k) of the Exchange Act. Currently, Virt-X Exchange Limited (''Virt-X'') is operating under an exemption from registration as a national securities exchange based on limited volume. However, the Commission exempted Virt-X from Rules 6a–1, 6a–2 and 6a–3 under the Exchange Act. *See* Securities Exchange Act Release No. 41199 (March 22, 1999), 64 FR 14953 (March 29, 1999). Therefore, the Commission has determined not to include Virt-X as a respondent to the collection of information.

[542] The national securities association is the NASD. There currently are no registered affiliated securities associations.

[543] The current average burden of 47 hours for filing an initial application for registration on Form 1 is based on the Paperwork Reduction Act update as of Spring 2004.

[544] Current Rule 15Aa–1 under the Exchange Act, which prescribes Form X–15AA–1 as the initial registration application for associations, also does not have a pre-existing paperwork burden.

[545] The current average burden of 25 hours for filing annual and periodic updates on Form 1 is based on the PRA update for Form 1 as of Spring 2004.

[546] *See* Rules 19b–4(*l*) and (m) under the Exchange Act, 17 CFR 240.19b–4(*l*) and (m) (requiring SROs to post all proposed rule changes, as well as current versions of their rules, on their Web sites).

[547] The basis for the Commission's belief is the time estimated for posting by SROs on their Web sites of their proposed rule changes and current and complete versions of their rules. *See* Exchange Act Release No. 50486, *supra* note 423.

[548] The Commission estimates that an initial application and copies would weigh approximately 180 lbs and would be mailed via courier/shipping service.

[549] *Id.*

[550] The Commission estimates that an amendment and copies would weigh approximately 60 lbs and would be mailed via courier/shipping service.

[551] This total includes the burden of preparing and submitting the initial registration form, but does not include any initial start-up burden for creating a website (this is a burden on which the Commission is soliciting comments).

an association that submits an initial registration application on the new Form 2 would be 157 hours and $673.33 per applicant.[552] For associations that are already registered with the Commission, the estimated reporting and recordkeeping burden for filing a complete new Form 2 and any requisite updating amendments for the first year in which the final rules are published would be 177 hours and approximately $1,039 per association. Thus, the Commission estimates that the total recordkeeping and reporting burden for the one registered association for the first year in which the final rules are published would be 177 hours and approximately $1,039. After the year in which an association initially files the new Form 2, the Commission estimates that such association would bear an annual reporting and recordkeeping burden of 48 hours and $731.72.

5. Collections of Information are Mandatory

These collections of information would be mandatory. The collections of information filed with the Commission on revised Form 1 and new Form 2 with the Commission would be available to the public.

6. Record Retention Period

Exchanges and associations would be required to retain any collections of information required by revised Form 1 and new Form 2, respectively, in accordance with, and for the periods specified in, Exchange Act Rule 17a–1.[553]

C. Proposed Rules 6a–5 and 15Aa–3

Proposed Rules 6a–5 and 15Aa–3 contain ''collection of information'' requirements within the meaning of the PRA.[554] The Commission has submitted them to the OMB for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title of the new collection of information under proposed Rules 6a–5 and 15Aa–3 under the Exchange Act is ''Rules 6a–5 and 15Aa–3: Fair Administration and Governance of National Securities Exchanges and Registered Securities Associations.'' OMB has not yet assigned a control number for the new collection of information contained in proposed Rules 6a–5 and 15Aa–3 under the Exchange Act. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.[555]

1. Summary of Collection of Information

Proposed Rules 6a–5 and 15Aa–3 under the Exchange Act would require national securities exchanges and registered securities associations to comply with, and have rules that comply with, the proposed rules' requirements, which are designed to facilitate the fair administration and governance of exchanges and associations. Various provisions of the proposed rules' also would apply to any ''regulatory subsidiary'' of the exchange or association.[556]

In particular, proposed Rules 6a–5(c)(2) and 15Aa–3(c)(2) under the Exchange Act would require the board of each SRO to affirmatively determine that each independent director has no material relationship with the national securities exchange or registered securities association, or any affiliate of the national securities exchange or registered securities association.[557] The board must make this determination upon the director's nomination or appointment to the board and thereafter no less frequently than annually and as often as necessary in light of the director's circumstances.[558] In order to allow the board to obtain the information necessary to make such determination, proposed Rules 6a–5(c)(3) and 15Aa–3(c)(3) would require a national securities exchange or registered securities association to establish policies and procedures to require each director, on his or her own initiative and upon request of the exchange or association, to inform the exchange or association of the existence of any relationship or interest that may reasonably be considered to bear on whether such director is an independent director. If the exchange or association were to request to receive this information from such directors, that would be a collection of information.

In addition, proposed Rules 6a–5(o)(5) and 15Aa–3(o)(5) under the Exchange Act would require a national securities exchange or registered securities association to have an effective mechanism for obtaining information from any owner of any interest in such exchange or association or any facility of such exchange or association relating to such ownership interest. If the exchange or association were to request to receive such information from such owners, that would be a collection of information.

Proposed Rules 6a–5(n)(4)(ii) and 15Aa–3(n)(4)(ii) under the Exchange Act would require national securities exchanges and registered securities associations to make and keep books and records necessary to evidence their compliance with proposed Rules 6a–5(n)(4)(i) and 15Aa–3(n)(4)(i).[559] However, the Commission believes that any reporting and recordkeeping burden that would be imposed by proposed Rules 6a–5(n)(4)(ii) and 15Aa–3(n)(4)(ii) would fall under the paperwork burden for Rule 17a–1 under the Exchange Act, which requires exchanges and associations to keep a copy of all documents and other such records as shall be made or received by them in the course of their business as such and in the conduct of their self-regulatory activities for a period of not less than five years.[560] The Commission preliminarily believes that exchanges already maintain records relating to the collection and use of regulatory fees, fines or penalties pursuant to Rule 17a–1 as part of their usual and customary activities and therefore such collection would not result in a burden under the PRA.[561] The Commission requests comment on whether exchanges already maintain these records.

With the exception of proposed Rules 6a–5(c)(3) and (o)(5) and 15Aa–3(c)(3) and (o)(5), the Commission believes that any other collection of information, within the meaning of the PRA, that would be imposed by proposed Rules 6a–5 and 15Aa–3 would be covered pursuant to the approved collection of information for Exchange Act Rule 19b–4.[562] In this regard, the Commission notes that exchanges and associations likely would need to amend their rules (including their or their regulatory

[552] This total includes the burden of preparing and submitting the initial registration form, but does not include any initial start-up burden for preparation for compliance with the Internet posting requirement (this is a burden on which the Commission is soliciting comments).

[553] 17 CFR 240.17a–1.

[554] 44 U.S.C. 3501 *et seq.*

[555] *See* 44 U.S.C. 3512.

[556] Pursuant to proposed Rules 6a–5(b)(18) and 15Aa–3(b)(19), ''regulatory subsidiary'' would mean any person that, directly or indirectly, is controlled by the national securities exchange or registered securities association, as applicable, and that provides, whether pursuant to contract, agreement or rule, regulatory services to or on behalf of the national securities exchange or registered securities association, as applicable. Several SROs have delegated to one or more subsidiaries the responsibility to carry out certain functions arising out of the SRO's obligations under the Exchange Act. *See supra* notes 78–81 and accompanying text.

[557] *See* proposed Rules 6a–5(c)(2) and 15Aa–3(c)(2).

[558] *See id.*

[559] Proposed Rules 6a–5(n)(4)(i) and 15Aa–3(n)(4)(i) would prohibit an exchange or association, respectively, from applying regulatory fees, fines or penalties to fund anything other than programs and operations directly related to their regulatory responsibilities. *See* discussion *supra* at II.B.8.b.

[560] 17 CFR 240.17a–1.

[561] *See* 5 CFR 1320.3(b)(2).

[562] 17 CFR 240.19b–4.

subsidiary's or facility's constitutions, charters, bylaws, rules or other governing documents) to comply with proposed Rules 6a–5 and 15Aa–3. Pursuant to Exchange Act Rule 19b–4, any such amendments would need to be filed with the Commission as proposed rule changes. The Commission notes that provisions of the proposed governance standards that would result in paperwork burdens for exchanges and associations, including with respect to any regulatory subsidiaries, would encompass: (i) A written charter for each Standing Committee; [563] (ii) a code of conduct and ethics and governance guidelines; [564] (iii) annual performance evaluations of each Standing Committee; [565] (iv) policies and procedures to require each director to inform the exchange or association of the existence of any relationship or interest that may reasonably be considered to bear on whether such director is an independent director; [566] (v) provisions relating to the fair representation of members; [567] (vi) policies and procedures for the separation of regulatory and market functions; [568] (vii) policies and procedures with respect to the dissemination of regulatory information and confidential information; [569] and (viii) rules that limit ownership and voting by members.[570] However, this collection of information would be collected pursuant to Exchange Act Rule 19b–4 and therefore would not be a new collection of information for proposed Rules 6a–5 and 15Aa–3.

2. Proposed Use of Information

The purpose of the collection of information in proposed Rules 6a–5(c)(3) and 15Aa–3(c)(3) is to enable national securities exchanges and registered securities associations to monitor the independence of their directors. This collection of information would provide exchanges and associations with a mechanism to determine whether they are in compliance with the requirement that their board be composed of a majority of independent directors,[571] as well as allow the board to affirmatively determine that a director has no material relationship with the exchange or association or any affiliate of the exchange or association.[572]

The purpose of the collection of information in proposed Rules 6a–5(o)(5) and 15Aa–3(o)(5) is to enable national securities exchanges and registered securities associations to monitor ownership of the exchange, association, or facility thereof, and analyze their capacity to meet their statutory responsibilities under Sections 6, 15A, 17, and 19 of the Exchange Act.[573] In this manner, investor confidence in the integrity of the marketplace would be enhanced.

Further, the collection of information may aid the exchange or association in complying with the disclosure requirements pertaining to director independence and ownership that are contained in revised Form 1 and new Form 2.

3. Respondents

The proposed collection of information in proposed Rules 6a–5(c)(3) and 15Aa–3(c)(3) would apply to nine national securities exchanges, one registered securities association and each director of a national securities exchange or registered securities association. The proposed collection of information in proposed Rules 6a–5(o)(5) and 15Aa–3(o)(5) would apply to nine national securities exchanges, one registered securities association and the owners of voting and ownership interests in each national securities exchange, national securities association, or facility of a national securities exchange or national securities association.

4. Reporting and Recordkeeping Burden

The Commission is unable to estimate precisely how many responses per year would be generated by proposed Rules 6a–5(c)(3) and 15Aa–3(c)(3), because any collection of information by an exchange or association from its directors would differ depending upon the number of directors on the exchange's or association's board, and also would depend on how often the board is required to request such information based on a director's circumstances. The Commission preliminarily estimates, however, that each exchange or association would request information approximately 2 times per year from approximately 17 directors, and that each request for information and response from each director would require approximately 1 hour to prepare and $0.37 to send,[574] for a total annual reporting and recordkeeping burden of 2 hours and $0.74 per director and 34 hours and $12.58 per exchange or association, for a total annual reporting and recordkeeping burden of 680 hours and approximately $252. The Commission specifically requests comment on these estimates.

The Commission is unable to estimate precisely how many responses per year would be generated by proposed Rules 6a–5(o)(5) and 15Aa–3(o)(5) under the Exchange Act, because any collection of information by an exchange or association from an owner of the exchange or association, or a facility of the exchange or association, would differ depending upon the number of shareholders or other owners of the exchange, association or facility. The Commission preliminarily estimates, however, that each exchange or association would request information approximately 2 times per year from approximately 500 owners and that it would cost each exchange or association $1.29 [575] to mail the request to each owner, resulting in a total annual cost of $1,290 to each exchange or association and $12,900 annually for all exchanges and associations. The Commission also estimates that the initial preparation and sending of the request for information would require approximately 4 hours, the preparation and sending of each subsequent request would require 2 hours, and reviewing the responses to each of the 2 annual requests for information would require 5 hours, for a total initial annual reporting and recordkeeping burden of 16 hours for each exchange or association and an annual burden of 14 hours thereafter, and a total initial annual burden for all exchanges and associations of 160 hours and an annual burden of 140 hours thereafter. The Commission preliminarily estimates that each owner would require 1 hour

[563] *See* proposed Rules 6a–5(f)(2), (g)(2), (h)(2), (i)(2), and (j)(2) and 15Aa–3(f)(2), (g)(2), (h)(2), (i)(2), and (j)(2). The Standing Committees are the Nominating Committee, Governance Committee, Compensation Committee, Audit Committee, and Regulatory Oversight Committee. *See* proposed Rules 6a–5(b)(21) and 15Aa–3(b)(22).

[564] *See* proposed Rules 6a–5(p) and (q) and 15Aa–3(p) and (q).

[565] *See* proposed Rules 6a–5(f)(5), (g)(3), (h)(3), (i)(3) and (j)(6) and 15Aa–3(f)(5), (g)(3), (h)(3), (i)(3) and (j)(6).

[566] *See* proposed Rules 6a–5(c)(3) and 15Aa–3(c)(3).

[567] *See* proposed Rules 6a–5(c)(4), (c)(7) and (f)(3) and 15Aa–3(c)(4), (c)(7) and (f)(3).

[568] *See* proposed Rules 6a–5(n)(1) and 15Aa–3(n)(1).

[569] *See* proposed Rules 6a–5(n)(5) and 15Aa–3(n)(5).

[570] *See* proposed Rules 6a–5(o) and 15Aa–3(o).

[571] *See* proposed Rules 6a–5(c)(1) and 15Aa–3(c)(1).

[572] *See* proposed Rules 6a–5(c)(2) and 15Aa–3(c)(2).

[573] 15 U.S.C. 78f, 78*o*–3, 78q, and 78s.

[574] The Commission assumes that each request and response will weigh one ounce and will be mailed via first class mail at a rate of $0.37 per ounce.

[575] The Commission assumes that the request will weigh five ounces and will be mailed via first class mail at a rate of $0.37 for the first ounce and $0.23 for each additional ounce, for a total of $1.29.

to prepare and $1.29 [576] to send to the exchange or association his or her response to the request, for a total annual reporting and recordkeeping burden of 2 hours and $2.58 for each owner and a total annual burden for all owners of 10,000 hours and $12,900. The Commission requests comment on these estimates.

Thus, the Commission estimates that the total annual reporting and recordkeeping burden for proposed Rules 6a5–3 and 15Aa–3 would be 10,840 hours and approximately $26,052. The Commission requests comment on this estimate.

5. Collection of Information is Mandatory

The collection of information under proposed Rules 6a–5(c)(3) and (o)(5) and 15Aa–3(c)(3) and (o)(5) would be mandatory. The collection of information under proposed Rules 6a–5(c)(3) and 15Aa–3(c)(3) would be required from directors of the exchange or association upon the request of the exchange or association. The collection of information under proposed Rules 6a–5(o)(5) and 15Aa–3(o)(5) would be required from owners of an exchange or association, or a facility of the exchange or association, upon the request of the exchange or association. The ownership information would be made public if such information were required to be disclosed by the exchange or association pursuant to the proposed changes to revised Form 1 and new Form 2, which would require exchanges and associations to report certain information with regard to any person that, alone or together with its related persons, directly or indirectly beneficially owns more than 5% of any class of securities or other ownership interest in the exchange, association, or any facility of the exchange or association.[577]

6. Record Retention Period

Exchanges and associations would be required to retain any collection of information required under proposed Rules 6a–5(c)(3) and (o)(5) and 15Aa–3(c)(3) and (o)(5), as applicable, in accordance with, and for the periods specified in, Exchange Act Rule 17a–1.[578]

D. Proposed Regulation AL

Proposed Regulation AL contains ''collection of information'' requirements within the meaning of the PRA.[579] The Commission has submitted them to the OMB for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title of the new collection of information under proposed Regulation AL under the Exchange Act is ''Regulation AL.'' OMB has not yet assigned a control number to the new collection of information contained in proposed Regulation AL under the Exchange Act. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.[580]

1. Summary of Collection of Information

Pursuant to proposed Rule 800(b)(2)(i), if an affiliated security is listed on, approved for trading on, or trades pursuant to the rules of, a national securities exchange or registered securities association, the exchange or association would be required to file quarterly reports with the Commission summarizing such exchange's or association's (1) monitoring of the affiliated security's compliance with the exchange's or association's listing rules, including an explanation of such affiliated security's compliance with each applicable rule, and (2) surveillance of the trading of the affiliated securities by its members.[581]

Pursuant to proposed Rule 800(b)(2)(ii), if an affiliated security is listed on, approved for trading on, or trades pursuant to the rules of, a national securities exchange or registered securities association, the exchange or association would be required to file annually with the Commission a report prepared by a third party analyzing compliance by the affiliated security with the exchange's or association's listing rules.[582] Moreover, proposed Rule 800(b)(2)(iii)–(v) would require, in the event that the exchange or association alleges that the affiliated security is not in compliance with any applicable listing rule of the exchange or association, the exchange or association to: (1) Promptly notify the affiliated issuer; (2) file a report with the Commission within five days of providing such notice to the affiliated issuer, identifying the date on which the exchange or association alleged that the affiliated security was not in compliance, the action the exchange or association proposes to take, the applicable listing rule, and any other material information conveyed to the affiliated issuer; [583] and (3) provide the Commission with a copy of any response from the affiliated issuer regarding its alleged non-compliance.

2. Proposed Use of Information

The purpose of the collection of information in proposed Regulation AL is to provide further assurance that SROs carry out their regulatory responsibilities under the Act with respect to surveillance of affiliated securities, and provide the Commission greater ability to monitor the efforts of SROs.

3. Respondents

If an affiliated security is listed on, approved for trading on, or trades pursuant to the rules of, an exchange or association, the exchange or association would be required to comply with proposed Regulation AL. The Commission estimates that eight registered national securities exchanges and one registered securities association would potentially be subject to proposed Regulation AL.[584]

4. Reporting and Recordkeeping Burden

Although it is difficult to predict how often an exchange or association would list or trade an affiliated security that would trigger the requirements of proposed Regulation AL, for purposes of this Paperwork Reduction Act analysis the Commission estimates one such occurrence for each exchange and association.[585] The Commission specifically requests comment on this estimate.

With regard to the requirement of proposed Rule 800(b)(2)(i) that would require an exchange or association to

[576] The Commission assumes that each response will weigh five ounces and will be mailed via first class mail at a rate of $0.37 for the first ounce and $0.23 for each additional ounce, for a total of $1.29.

[577] *See supra* Sections IV.C.2. and IV.C.9. for a discussion of Exhibits C and Q in revised Form 1 and new Form 2.

[578] 17 CFR 240.17a–1.

[579] 44 U.S.C. 3501, *et seq.*

[580] 44 U.S.C. 3512.

[581] Such report must be approved by the exchange's or association's Regulatory Oversight Committee. *See* proposed Rule 800(c)(i).

[582] Such report must be filed no later than 60 calendar days following the end of the exchange's or association's fiscal year. *See* proposed Rule 800(b)(2)(ii).

[583] Such report must be approved by the exchange's or association's Regulatory Oversight Committee. *See* proposed Rule 800(c)(i).

[584] ISE, which does not have rules to list or trade any securities other than standardized options (which the Commission has proposed to exempt from the definition of ''affiliated security''), would not be subject to proposed Regulation AL. In addition, because the Commission has proposed to exempt security futures products from the definition of ''affiliated security,'' the two national securities exchanges registered pursuant to Section 6(g) of the Exchange Act and the limited purpose national securities association registered pursuant to Section 15A(k) of the Exchange Act would not be required to comply with proposed Regulation AL.

[585] The Commission notes that currently one exchange and one association would be subject to proposed Regulation AL with respect to one affiliated security each.

file quarterly reports with the Commission summarizing its monitoring of the listing and trading of the affiliated security on its facilities, the Commission understands that the exchanges and associations already have in place systems to monitor the compliance of listed securities with their listing rules and to monitor the trading of such securities through their facilities. The Commission preliminarily does not believe that exchanges or associations would need to make significant changes to these systems to comply with proposed Regulation AL, and that the cost of the monitoring and surveying pursuant to proposed Rule 800(b)(2)(i) would be incremental and insubstantial. The Commission recognizes, however, that exchanges and associations may need to conduct a review of an affiliated security's compliance with its listing standards more frequently to meet the quarterly reporting requirements, if the exchange or association does not currently conduct such review at least quarterly. The Commission preliminarily believes that exchanges and associations currently review for compliance on a quarterly basis, but assumes for purposes of estimating the burden of these proposed requirements that each SRO would perform two additional reviews per year and that an exchange or association would incur an additional burden of 8 hours per review, resulting in a total annual reporting and recordkeeping burden of 144 hours. The Commission requests comment on this estimate and whether SROs would need to perform any additional reviews to comply with the proposed requirements.

In addition, the Commission estimates that each of the eight registered national securities exchanges and the one registered securities association would spend $1.29 [586] to send each report to the Commission, 17 hours preparing and filing the initial quarterly report and 12 hours for each quarterly report thereafter to comply with the proposed rule, for a total of $5.16 and 53 hours per exchange or association for the first year and $5.16 and 48 hours per exchange or association for subsequent years, resulting in an initial total annual reporting and recordkeeping burden of $46.44 and 477 hours and a total annual burden of $46.44 and 432 hours thereafter. The Commission specifically solicits comment on these estimates and whether SROs would be required to modify their systems to comply with this proposed quarterly reporting requirement.

With regard to the requirement that an exchange or association file annually with the Commission a report prepared by a third party analyzing compliance by an affiliated security with the exchange's or association's listing rules, the Commission estimates that each exchange or association would spend approximately 5 hours interacting with the third party with respect to their preparation of the report, 4 hours reviewing each report received from the third party, and $1.29 [587] to send each report to the Commission, for a total of $1.29 and 9 hours per exchange or association per year, for a total annual reporting and record keeping burden of $11.61 and 81 hours for all exchange and associations. The Commission estimates that it would take each third party approximately 22 hours to prepare and file each annual report, for a total annual cost per exchange or association of $6,600,[588] resulting in a total annual cost burden of approximately $59,400.

With regard to the requirement in proposed Rule 800(b)(2)(iii) that an exchange or association promptly notify an affiliated issuer of alleged non-compliance with listing rules, the Commission believes that exchanges and associations currently have rules for the provision of notice to listed companies that fail to continue to meet certain listing requirements. Therefore, the Commission believes that any additional paperwork burden on the exchange or association created by this proposed requirement would be incremental and insubstantial. The Commission recognizes, however, that exchanges and associations may incur additional costs if they were required to notify an affiliated issuer more often than pursuant to their existing rules. The Commission does not know precisely how frequently notification would be required under the proposed rule, but estimates that each exchange or association would spend approximately 2 hours and $1.29 [589] to prepare and send each notification. The Commission requests comment on this estimate and whether exchanges' and associations' existing rules would require them to provide the notice to affiliated issuers that would be required by the proposed rule, and if so, whether their rules would require the notice to be required more often than pursuant to their existing rules.

Pursuant to proposed Rule 800(b)(2)(iv), if an affiliated security was alleged not to be in compliance with an exchange's or association's listing rules, the exchange or association would have to file a report with the Commission identifying the date the exchange or association alleged that the affiliated security was not in compliance, the action the exchange or association proposes to take, the applicable listing rule, and any other material information conveyed to the affiliated issuer. The Commission does not know how many responses would be generated by this requirement because it is unknown whether, or how often, an exchange or association would allege that an affiliated security fails to comply with the exchange's or association's listing rules, but estimates that a national securities exchange or registered securities association would spend approximately 5 hours per report and $1.29 [590] to send each report to the Commission to comply with the proposed rule. Assuming that each exchange and association had one affiliated security, and assuming that the exchange or association alleged that the affiliated security failed to comply with the exchange's or association's listing rules at least once per year, that would result in an annual total burden of 45 hours and $11.61.[591] For the same reason, the Commission does not know how many responses the exchange or association would receive from an affiliated issuer to whom it gave notice of non-compliance for which the exchange or association would need to file a copy with the Commission pursuant to proposed Rule 800(b)(2)(v). The Commission, however, estimates that an exchange or association would spend approximately 2 hours and $1.29 [592] per response to comply with the proposed requirement to file a copy

[586] The Commission assumes that each report will weigh five ounces and will be mailed via first class mail at a rate of $0.37 for the first ounce and $0.23 for each additional ounce, for a total of $1.29.

[587] The Commission assumes that each report will weigh five ounces and will be mailed via first class mail at a rate of $0.37 for the first ounce and $0.23 for each additional ounce, for a total of $1.29.

[588] The estimate assumes that the report will be prepared by outside legal counsel for the exchange or association at an estimated cost of $300 per hour, based on an hourly estimate for outside legal services obtained from industry sources. The Commission requests comment on this estimate, and on what type of entity the SRO may hire to prepare this report.

[589] The Commission assumes that each notice will weigh five ounces and will be mailed via first class mail at a rate of $0.37 for the first ounce and $0.23 for each additional ounce, for a total of $1.29.

[590] The Commission assumes that each report will weigh five ounces and will be mailed via first class mail at a rate of $0.37 for the first ounce and $0.23 for each additional ounce, for a total of $1.29.

[591] The Commission believes this likely overestimates the burden because it would assume that each affiliated security fell out of compliance each year. The Commission requests comment on this estimate.

[592] The Commission assumes that each response will weigh five ounces and will be mailed via first class mail at a rate of $0.37 for the first ounce and $0.23 for each additional ounce, for a total of $1.29.

of the response with the Commission. Assuming that each affiliated issuer responded once, that would result in a total annual burden of 2 hours per respondent, or 18 total hours. Thus, based on information available to the Commission at this time, the estimated total initial annual burden for proposed Regulation AL for all respondents would be 783 hours and approximately $59,504 and 738 hours and approximately $59,504 thereafter. The Commission requests comment on the estimates included in this analysis.

5. Collection of Information Is Mandatory

The collection of information would be mandatory if an affiliated security is listed on, approved for trading on, or trades pursuant to the rules of, an exchange or association. The collection of information filed pursuant to proposed Regulation AL with the Commission would be available to the public unless the exchange or association requested, and the Commission granted, confidential treatment pursuant to existing Commission rules and statutory authority.

6. Record Retention Period

Exchanges and associations would be required to retain any collection of information required under proposed Regulation AL in accordance with, and for the periods specified in, Exchange Act Rule 17a–1.[593]

E. Proposed Amendments to Rule 17a–1

The proposed amendments to Rule 17a–1 under the Exchange Act do not impose any new recordkeeping or information collection requirements, or other collections of information that require approval of OMB under 44 U.S.C. 3501, *et seq.* Accordingly the PRA does not apply.

F. Proposed Rule 17a–26

Proposed Rule 17a–26 contains ''collection of information'' requirements within the meaning of the PRA.[594] The Commission has submitted them to the OMB for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title of the new collection of information under proposed Rule 17a–26 under the Exchange Act is ''Rule 17a–26: Regulatory Reports of National Securities Exchanges and Registered Securities Associations.'' OMB has not yet assigned a control number for the new collection of information contained in proposed Rule 17a–26 under the Exchange Act. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.[595]

1. Summary of Collection of Information

Proposed Rule 17a–26 under the Exchange Act would require national securities exchanges and registered securities associations to file with the Commission quarterly and annual reports, in electronic format, that provide details on the operation of their self-regulatory programs. In the proposed quarterly reports, exchanges and associations would be required to file with the Commission information on specified matters regarding their regulatory programs, including results of their surveillance programs; summaries of complaints relating to the operation of their regulatory programs; summaries of all investigations, examinations, and enforcement cases active during the reporting period; summaries of listings activity; and copies of the agenda of any board or board committee meeting that occurred during the quarter. In the proposed annual reports, exchanges and associations would be required to file with the Commission a year-end aggregation of the information submitted pursuant to the proposed quarterly reporting requirement, except for the board and board committee agenda; a discussion of their regulatory processes; an organizational staffing chart; an evaluation of the effectiveness of their regulatory programs; a discussion of their internal controls; a summary of employment arrangements with the Chief Regulatory Officer and senior regulatory personnel; copies of the most recent annual performance evaluation of the Standing Committees of the board (*i.e.*, Nominations, Compensation, Audit, and Regulatory Oversight Committees) and of the most recent annual performance evaluation of the Governance Committee; a discussion of efforts to comply with any recommendations or plan resulting from any inspection or examination conducted by Commission staff; and a report of a third-party audit of any electronic SRO trading facility owned, operated, or sponsored by the exchange or association. Exchanges and associations would be required to submit supplemental filings to report interim changes to their regulatory programs. The proposed rule also would direct each exchange and association to establish procedures for the preparation of the quarterly and annual reports in a uniform, readily accessible, and usable electronic format.

2. Proposed Use of Information

The purpose of the collection of information in proposed Rule 17a–26 is to enhance the Commission's ability to monitor compliance by national securities exchanges and registered securities associations with their regulatory responsibilities and to support the Commission's program of examinations of self-regulatory organizations. The information collected should help to keep the Commission informed of new developments and challenges affecting the regulatory programs of exchanges and associations, and should assist the Commission in more closely monitoring the exchanges' and associations' responses to critical regulatory issues affecting them. The collection of the information also should aid the Commission in better targeting its inspection resources.

3. Respondents

The proposed collection of information in proposed Rule 17a–26 would apply to every national securities exchange and every registered securities association, other than a national securities exchange registered pursuant to Section 6(g) of the Exchange Act [596] and a limited purpose national securities association registered pursuant to Section 15A(k)(l) of the Exchange Act,[597] which at this time includes nine registered national securities exchanges and one registered securities association.

4. Reporting and Recordkeeping Burden

The Commission believes that national securities exchanges and registered securities associations currently collect and retain much of the data that would be necessary to prepare the quarterly and annual reports that would be required by the proposed rule in connection with the execution of their self-regulatory responsibilities. To comply with the proposed rule, however, exchanges and associations would incur an additional burden in assembling the information into quarterly and annual reports and filing those reports with the Commission. The Commission expects that requiring the collection of information to be submitted in electronic format should lessen the burden on exchanges and associations, as well as reduce the burdens of printing, transmission, and

[593] 17 CFR 240.17a–1.

[594] 44 U.S.C. 3501, *et seq.*

[595] 44 U.S.C. 3512.

[596] 15 U.S.C. 78f(g).

[597] 15 U.S.C. 78*o*–3(k)(l).

record retention that are typically incurred with hardcopy reports.

Based on information available to the Commission at this time, the Commission estimates that each national securities exchange and registered securities association would incur an average burden of 40 hours to prepare each quarterly report and 35 hours to prepare each annual report, for an annual burden of 195 hours per respondent. Accounting for nine national securities exchanges and one registered securities association, the total burden to comply with the quarterly and annual reporting requirements in proposed new Rule 17a–26 is therefore estimated to be 1,950 hours per year. The Commission is unable to estimate with certainty the number of interim updates an exchange or association would need to file, since the need for any such updates would depend on each exchange's or association's particular circumstances. Nevertheless, for purposes of this burden analysis, the Commission estimates that an exchange or association would incur a burden of 4 hours to prepare each interim updating amendment, which would likely be required, on average, 5 times per year for a total of 20 hours per respondent and 200 hours total for the nine exchanges and one association. The Commission requests comment on the accuracy of these estimates. The total burden resulting from the proposed rule's quarterly and annual reporting provisions is estimated to be 2,150 hours and $60 [598] to prepare and file with the Commission each report and interim supplement.

For those exchanges or associations that own, operate, or sponsor an electronic SRO trading facility, the proposed rule would require such exchange or association to file annually with the Commission, as part of its annual report, an audit report prepared by an independent third party with respect to the electronic SRO trading facility or facilities of the exchange or association. The Commission estimates that nine national securities exchanges and one registered securities association would be required to obtain an annual audit, and each such exchange or association owning, operating, or sponsoring at least one such facility would spend approximately 15 hours interacting with the third party with respect to their conduct of the audit and preparation of the audit report and 20 hours reviewing each audit report received from the third party, for a total of 35 hours per exchange or association per year, for a total annual reporting and recordkeeping burden of 350 hours. With respect to the third-party auditor, the Commission estimates that it would take each third party 100 hours to conduct the audit of any such facility or facilities and prepare the audit report for each exchange or association that owns, operates, or sponsors at least one electronic SRO trading facility, for a total annual cost per exchange or association of $15,000,[599] resulting in a total annual burden cost of $150,000.

With respect to the burden imposed on exchanges and associations in connection with establishing procedures for the preparation of the reports required by the proposed rule in a uniform, readily accessible, and usable electronic format, based on information available to the Commission, the Commission estimates that each exchange or association would spend approximately 35 hours during the initial year of the proposed rule's effectiveness to comply with this requirement. Accounting for nine national securities exchanges and one registered securities association, the total burden per year to comply with the provision in proposed Rule 17a–26 regarding the uniform format for the quarterly and annual reports is estimated to be 350 hours.

Thus, based on information available to the Commission at this time, the estimated total reporting and recordkeeping burden for proposed Rule 17a–26 is 2,850 hours and $150,060. The Commission requests comment on the accuracy of these estimates.

5. Collection of Information Is Mandatory

The collection of information in proposed Rule 17a–26 under the Exchange Act would be mandatory. An exchange or association could request confidential treatment of any report or other information that the exchange or association provides to the Commission pursuant to proposed Rule 17a–26. The Commission would accord confidential treatment to the information to the extent permitted by law.

6. Record Retention Period

Exchanges and associations would be required to retain any collection of information required under proposed Rule 17a–26 in accordance with, and for the periods specified in, Exchange Act Rule 17a–1.[600]

G. Proposed Rule 17a–27

Proposed Rule 17a–27 under the Exchange Act contains ''collection of information'' requirements within the meaning of the PRA.[601] The Commission has submitted them to the OMB for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title of the new collection of information under proposed Rule 17a–27 under the Exchange Act is ''Rule 17a–27: Ownership of a National Securities Exchange, Registered Securities Association, Facility of a National Securities Exchange, or Registered Securities Association.'' OMB has not yet assigned a control number for the new collection of information contained in proposed Rule 17a–27 under the Exchange Act. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.[602]

1. Summary of Collection of Information

Proposed Rule 17a–27(b) under the Exchange Act would require any member of a national securities exchange or registered securities association that is a broker or dealer to file a statement with the Commission if such member, alone or together with its related persons, directly or indirectly beneficially owns more than 5% of any class of securities or other ownership interest of an exchange or association of which it is a member or any facility of an exchange or association through which the member is permitted to effect transactions.[603] The member would be required to include in the statement certain information about the member and its related persons, information about the securities or other ownership interest that is the subject of the filing, detailed information about the member and its related persons' holdings, and a description of the ability of the member

[598] The Commission estimates that an average filing will weigh two ounces, accounting for a diskette and accompanying letter, and will be mailed via first class mail at a rate of $0.37 for the first ounce and $0.23 for the additional ounce, for a total of $0.60 per filing. At four quarterly reports, one annual report, and an estimated five interim supplements, the Commission expects that each exchange or association would incur a cost of $6 to comply with the proposed rule. The Commission solicits comments on the accuracy of this estimate.

[599] The estimate assumes that the report will be prepared for the exchange or association by an independent accounting firm or similar entity at an estimated cost of $150 per hour, based on an hourly estimate for auditing services obtained from industry sources. The Commission requests comment on this estimate, and on what type of entity an exchange or association may hire to prepare this report.

[600] 17 CFR 240.17a–1.

[601] 44 U.S.C. 3501, *et seq.*

[602] 44 U.S.C. 3512.

[603] A member would be required to file the initial statement within ten calendar days of becoming subject to the requirements of proposed Rule 17a–27(b). *See* proposed Rule 17a–27(b)(3).

and its related persons to control the exchange or association.[604]

Pursuant to proposed Rule 17a–27(b)(4), a member would be required to file a periodic amendment to the statement within ten calendar days of any change in the information required to be provided on the statement, except in the event of an increase or decrease of less than 1% of ownership of a class of securities or other ownership interest last reported on the statement, or any amendment thereto. Proposed Rule 17a–27(c) under the Exchange Act would require any member that is required to file the statement required pursuant to proposed Rule 17a–27(b)(1) or any amendment required pursuant to proposed Rule 17a–27(b)(4) to provide a copy of such statement or amendment to the exchange or association for which ownership information is being reported, or, if the relevant entity is a facility, to the applicable exchange or association.

Finally, proposed Rule 17a–27(d) under the Exchange Act would require an exchange or association that receives a copy of the report from a member to post the statement or amendment on a publicly-accessible Web site controlled by the exchange or association.

2. Proposed Use of Information

The purpose of the collection of information in proposed Rule 17a–27 is to enable the Commission and each exchange or association to monitor the accumulation of significant ownership interests in SROs by members, so as to further the ability of the SRO to perform its statutory obligations under the Exchange Act and the Commission's ability to perform its oversight responsibilities. Proposed Rule 17a–27 also would provide the Commission and each exchange or association with information relevant to monitor compliance with proposed Rules 6a–5(o) and 15Aa–3(o), which would require exchanges and associations to implement rules to prohibit their broker-dealer members from owning or voting more than 20% of the exchange, association, or a facility of the exchange or association, and an effective mechanism to divest any member and its related persons of any interest owned in excess of the 20% limitation.

3. Respondents

The requirements in proposed Rule 17a–27(b) to file a statement and updates with the Commission and in proposed Rule 17a–27(c) to provide a copy of the statement and any amendment to the applicable exchange or association would apply to the members of the nine registered national securities exchanges and the one registered securities association that are brokers or dealers and that beneficially own more than 5% of any class of securities or other ownership interest in the exchange or association, or a facility of the exchange or association through which such member is permitted to effect transactions. The Commission estimates that there are approximately 6,800 registered brokers and dealers [605] that would be subject to this requirement.[606] The requirement of proposed Rule 17a–27(d) that an exchange or association post a copy of any statement received from a member on an Internet Web site would apply to each of the nine registered exchanges and the one registered association.[607]

4. Reporting and Recordkeeping Burden

Because the amount of a member's interest in an exchange, association or facility could fluctuate, and because 5% is a fairly high threshold, the Commission is not able to determine with certainty how many broker-dealer members would be required to file a statement pursuant to proposed Rule 17a–27(b).[608] For purpose of this paperwork burden analysis, however, the Commission assumes that 100 of the 6,800 members that are brokers or dealers would file a statement with respect to ownership in one exchange or facility, and estimates that each of those members would amend such statement once per year.[609]

Based on information available to the Commission at this time, the Commission believes that, given the nature of their business, most members that would be subject to proposed Rule 17a–27 likely already have in place systems and procedures for tracking their ownership of securities, and that the new burden of tracking the ownership interests in an exchange, association or a facility necessary to prepare the statement required by proposed Rule 17a–27 would not be a substantial additional burden.[610] The Commission recognizes, however, that the scope of the reporting requirement may exceed the scope of ownership for which a member currently keeps records, since a member would need to aggregate its ownership interest with those of its related persons.

The Commission therefore estimates that proposed Rule 17a–27(b) would require approximately 35 hours per statement to prepare and file the initial statement,[611] that proposed Rule 17a–27(c) would require approximately 2

[604] *See supra* discussion in Section VI.B.

[605] Based on information available to the Commission at this time, there are approximately 6,800 registered brokers and dealers. Approximately 6,553 brokers and dealers filed FOCUS reports pursuant to 17 CFR 240.17a–5 (Exchange Act Rule 17a–5) at the end of 2003.

[606] Each registered broker or dealer must be either a member of an exchange or an association, and every member of an exchange or association is required to be a registered broker or dealer. *See* Section 15(b)(8) of the Exchange Act (15 U.S.C. 78*o*(b)(8)), Section 15A(g)(1) of the Exchange Act (15 U.S.C. 78*o*–3(g)(1)) and Section 6(b)(2) of the Exchange Act (15 U.S.C. 78f(b)(2)). The Commission believes, however, that using the number of registered brokers and dealers overestimates the number of members that would exceed the 5% ownership threshold and thus trigger the reporting requirements of proposed Rule 17a–27, given the amount of ownership it would take to trigger the requirement. The Commission requests comment on this estimate.

[607] The proposed rule would not apply to ownership in exchanges registered pursuant to Section 6(g) of the Exchange Act or limited purpose national securities associations registered pursuant to Section 15A(k)(l) of the Exchange Act. *See* proposed Rule 17a–27(a)(6).

[608] The Commission notes that although certain ownership information currently is reported to the Commission pursuant to Regulation 13D with respect to issuers registered pursuant to Section 12 of the Exchange Act, and Exhibit K to Form 1, which requires information with respect to each shareholder of an exchange that directly owns 5% or more of a class of a voting security of such exchange, information relating to members' interests in exchanges and associations and facilities generally is not currently required to be reported to the Commission.

[609] Based on the Commission's knowledge of exchanges that have demutualized and facilities of exchanges that the Commission has approved, the Commission estimates that the number of members that are brokers or dealers and that currently own more than 5% of an exchange, association or facility is less than 20, but has conservatively assumed 100 members would trigger the requirements of the proposed Rule. Furthermore, the Commission notes that the capital requirements necessary to enable a member to own more than 5% would be considerably high, and therefore limit the number of members likely to trigger the requirements. The Commission believes that this estimate overestimates the number of members that are brokers or dealers and that would own more than 5% of an exchange, association or facility, thus triggering the filing requirement of proposed Rule 17a–27. The Commission requests comment on this estimate, and a process for more accurately estimating the number of respondents.

[610] For example, to comply with Regulation 13D under the Exchange Act, 17 CFR 240.13d–1 through 13d–7, members must be able to track and report on Schedule 13D or Schedule 13G, 17 CFR 240.13d–1(a) and (b), as applicable, their beneficial ownership of any issuer specified in Exchange Act Rule 13d–1, 17 CFR 240.13d–1, if such beneficial ownership exceeds 5%. The Commission also believes it likely, given the nature of their business, that members keep records of their ownership in entities not covered by the requirements of Regulation 13D under the Act, particularly with respect to ownership in any exchange or association of which they are a member or any facility through which they effect transactions. The Commission requests comment on this belief.

[611] The Commission believes that this estimate may overestimate the amount of time required for members to prepare the statement, and requests comment on this estimate.

hours and $1.29[612] to prepare and send the copy of the statement or any amendment to the exchange or association, and that each amendment required by proposed Rule 17a–27(b)(4) would require 10 hours per amendment to prepare and file the amendment, for a total initial annual burden of 47 hours per respondent and 12 hours annually thereafter. Thus, based on information available to the Commission at this time, the Commission estimates the total initial annual burden imposed by proposed Rule 17a–27 on all members would be 4,700 hours and $258, and the annual burden thereafter would be 1,200 hours and $258. The Commission requests comment on the accuracy of these estimates.

If a national securities exchange or registered securities association receives a copy of a statement from a member pursuant to proposed Rule 17a–27(c), the exchange or association must post the statement on its Internet Web site pursuant to proposed Rule 17a–27(d). The Commission staff preliminarily estimates that 4 hours is the amount of time that would be required to post the statement on an exchange's or association's Web site.[613] The Commission staff estimates that the total annual burden for posting statements would be 400 hours. The Commission requests comment on its estimate of how long it would take an exchange or association to post a statement on its Web site.

Thus, the Commission estimates that the total initial annual reporting and recordkeeping burden for proposed Rule 17a–27 is 5,100 hours and $258, and 1,600 and $258 annually thereafter. The Commission requests comment on these estimates.

5. Collection of Information Is Mandatory

The collection of information under proposed Rule 17a–27 would be mandatory if a member that is a broker or dealer exceeds the ownership threshold. The collection of information required pursuant to proposed Rule 17a–27 would be provided by members to the Commission, as well as to the relevant exchange or association, and the exchange or association would be required by proposed Rule 17a–27(d) to post the information on its publicly available Web site.

6. Record Retention Period

Members would be required to retain any collection of information required under proposed Rule 17a–27 in accordance with, and for the periods specified in, Exchange Act Rules 17a–3 and 17a–4.[614] Exchanges and associations would be required to retain any collection of information required under proposed Rules 17a–27(c) and (d) in accordance with, and for the periods specified in, Exchange Act Rule 17a–1.[615]

H. Request for Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to: (i) Evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information would have practical utility; (ii) evaluate the accuracy of the Commission's estimates of the burden of the proposed collections of information and provide the Commission with data on proposed Rules 6a–2, 6a–5, 15Aa–1, 15Aa–2, 15Aa–3, 17a–26, 17a–27, Regulation AL, and revised Form 1 and new Form 2; (iii) enhance the quality, utility, and clarity of the information to be collected; and (iv) minimize the burden of the collections of information on those required to respond, including through the use of electronic or automated collection techniques or other forms of information technology.

Persons wishing to submit comments on the collection of information requirements should direct them to the following persons: (1) Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Office of Management and Budget, Washington, DC 20503; and (2) Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609, with reference to File No. S7–39–04. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, refer to File No. S7–39–04, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, 450 Fifth Street, NW., Washington, DC 20549–0609. As OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this release in the **Federal Register,** a comment to OMB is best assured of receiving full consideration if OMB receives it within 30 days of publication of this release.

X. Consideration of Costs and Benefits

The system of regulation of our nation's securities markets and market participants is grounded on the principle of self-regulation. Recent developments, including allegations of governance failures on the part of SROs, enforcement actions and examinations involving SROs and their members, increasing competitive pressures faced by SROs, and the growing trend of SROs to reorganize from mutual organizations to shareholder-owned entities, have prompted the Commission to review aspects of the SROs' governance and the transparency of their governance and regulatory processes. At the same time, the Commission has determined to review its regulation and oversight of SROs and to consider whether changes are necessary in light of recent developments involving SROs.[616]

Accordingly, the Commission is proposing to adopt new rules and amend existing rules and forms under the Exchange Act to strengthen SRO governance and the Commission's regulation and oversight of SROs. The proposals relate to the governance, administration, transparency, and ownership of SROs that are national securities exchanges and registered securities associations, and the periodic reporting of information by these SROs with respect to their regulatory programs. The proposals also relate to the listing and trading by SROs of their own or an affiliate's securities.

The Commission is sensitive to the costs and benefits that may result from the proposed rules and amendments, and has identified below certain costs and benefits associated with the proposals. The Commission encourages commenters to identify, discuss, analyze, and supply relevant data, including empirical data, regarding costs or benefits that may be associated with the proposals. The Commission preliminarily believes that the benefits of the proposed rulemaking to investors, users of the SROs' facilities, and other market participants, as well as the SROs, justify the costs.

A. Costs and Benefits of Proposed Rules 6a–5 and 15Aa–3

The Commission is proposing new Rules 6a–5 and 15Aa–3 under the Exchange Act that would set forth minimum standards of governance to be adopted and implemented by exchanges and associations, respectively. The

[612] The Commission assumes that the statement will weigh five ounces and will be mailed via first class mail at a rate of $0.37 for the first ounce and $0.23 for each additional ounce, for a total of $1.29.

[613] *See supra* note 547 and accompanying text.

[614] 17 CFR 240.17a–3 and 17a–4.

[615] 17 CFR 240.17a–1.

[616] *See supra* Section I.B. for a discussion of recent developments involving SROs.

proposed governance rules are intended to strengthen the governance of exchanges and associations, promote a greater degree of objectivity and impartiality in important SRO processes, foster a greater degree of independence of the regulatory programs of exchanges and associations, and address the conflicts that can arise when a mutual organization (such as an exchange) converts to another form of ownership.[617]

Proposed Rules 6a–5 and 15Aa–3 would require an exchange's or association's governing board to be composed of a majority of independent directors, with key board committees to be composed solely of independent directors (''Standing Committees''). For a director to be considered independent, the board of the exchange or association would be required to affirmatively determine that the director has no material relationship with the exchange or association or any affiliate of the exchange or association. The board would be required to make this determination upon the director's nomination or appointment to the board and thereafter no less frequently than annually and as often as necessary in light of the director's circumstances. Further, the exchange or association would be required to establish policies and procedures to require each director, on his or her own initiative and upon request of the exchange or association, to inform the exchange or association of the existence of any relationship or interest that may reasonably be considered to bear on whether such director is an independent director. Each Standing Committee would be required to conduct an annual self-evaluation of its performance, except that the Governance Committee would be required to conduct an annual evaluation of the governance of the exchange or association as a whole. Exchanges and associations would be required to provide sufficient funding and other resources to each Standing Committee, as determined by each Standing Committee, to permit it to fulfill its responsibilities and retain independent counsel and advisors. Additionally, the independent directors of the exchange's or association's board would be required to meet regularly in executive session, without the presence of management. When the board considered any matter that is recommended by or otherwise is within the authority or jurisdiction of any Standing Committee, a majority of the directors who vote on the matter would be required to be independent.

Under proposed Rules 6a–5 and 15Aa–3, each exchange and association would be required to separate its regulatory function from its market operations and other commercial interests, whether through functional or structural separation. Exchanges and associations also would be required to prevent the dissemination of regulatory and certain other information and to apply regulatory fees, fines, and penalties toward the funding of regulatory operations. In addition, the proposed governance rules would require exchanges and associations to impose on their members that are brokers or dealers ownership and voting limitations on their interest in the exchange, the association, or a facility of the exchange or association. Finally, the proposed governance rules would require that exchanges and associations adopt both a code of conduct and ethics for directors, officers and employees and governance guidelines.

To further strengthen the governance of exchanges and associations, the proposed rules also would apply to any person that, directly or indirectly, is controlled by the exchange or association and that provides, whether pursuant to contract, agreement or rule, regulatory services to or on behalf of the exchange or association (*i.e.,* a regulatory subsidiary), because they are an integral part of the SRO structure and carry out certain regulatory duties on behalf of the exchange or association. Thus, the Commission proposes to require these regulatory subsidiaries to be subject to the same governance standards applicable to the SRO itself.

The proposals contemplate that each exchange and association would file with the Commission proposed rule changes pursuant to Section 19(b) of the Exchange Act to amend their existing charters, bylaws, or rules to comply with the proposed rules.

1. Benefits

As discussed below, the Commission believes that exchanges and associations, as well as their members, users of their facilities, institutional and retail investors, shareholders or other owners of those exchanges that have demutualized, and the public generally, are likely to benefit significantly from the proposed governance rules.

The proposed rules are designed to enhance the independence and effectiveness of the boards of exchanges and associations, as well as their regulatory subsidiaries, by requiring those boards to be composed of a majority of independent directors. By mandating a structure that would require a majority of the board to be independent, the governance of these entities should be less susceptible to competing internal interests. The independent directors would constitute a majority of the SRO's board and thus should help foster a greater degree of independent decision-making by the exchange's and association's governing bodies. Further, a board whose independent directors constitute at least a majority of the board should help strengthen the hand of the independent directors when dealing with management. In the Commission's view, requiring SRO boards to have a majority of independent directors should help reduce conflicts of interest that otherwise might arise when persons with a nexus to the SRO are involved in key decisions. A board constituting a majority of independent directors also should help further the SRO's ability to meet its obligations under the Exchange Act, because those directors would not have relationships with the SRO, its members, or listed issuers that otherwise would impair disinterested viewpoints or judgments. Further, the requirement that each exchange and association establish policies and procedures to require each director on his or her own initiative or upon request of the exchange or association, to inform the exchange or association of the existence of any relationship or interest that may reasonably be considered to bear on whether such director is an independent director would aid the board in affirmatively determining whether such director could be considered independent. In addition, such requirement would provide the exchange or association with a mechanism by which to determine whether such exchange or association is in compliance with the majority independent board requirement. While meeting in executive session, free from the presence of management, the independent directors would be afforded the opportunity to discuss important matters regarding the exchange or association in a frank and open manner.

The proposed governance rules also would require that exchanges and associations, as well as their regulatory subsidiaries, administer a fair process that provides members with the opportunity to select at least 20% of the total number of directors.[618] The Nominating Committee would be required to nominate at least one director who is representative of issuers and at least one director who is

[617] *See supra* Section II.B. for a discussion of proposed Rules 6a–5 and 15Aa–3.

[618] *See* proposed Rule 6a–5(f)(3) and 15Aa–3(f)(3).

representative of investors and who, in each case, is not associated with a member or broker or dealer.[619] These proposals balance the Commission's goal of greater board independence with the right of members to participate in the governance of the exchange or association by providing members with a practical voice in exchange or association affairs, without jeopardizing the overall independence of the board.

Standing Committees composed solely of independent directors should result in a greater degree of objective decision-making with respect to the exchange's or association's core responsibilities. The Standing Committees' annual evaluation process should assist the exchange or association in identifying potential strengths and deficiencies in the governance, administration, regulatory programs and financial matters of the exchange or association and any regulatory subsidiary. Further, requiring exchanges and associations to provide sufficient funding and other resources to permit the independent directors and the Standing Committees to fulfill their responsibilities and to retain independent legal counsel and other advisors should provide independent directors with the ability to serve effectively.

Although the proposed governance rules do not require that an exchange's or association's Chairman be an independent director, the rules would require that if the exchange's or association's CEO is not also the Chairman, the Chairman must be an independent director.[620] Further, in the event an exchange or association elected to have a single individual serve as Chairman and CEO, the proposed governance rules would prohibit that person—who, as the CEO would not be ''independent''—from participating in any executive sessions of the board and from serving on any Standing Committee.[621] If a single individual served as both Chairman and CEO, the board would be required to designate an independent director as a lead director to preside over executive sessions of the board, and the board would be required to publicly disclose such lead director's name and a means by which interested parties may communicate with the lead director.[622] These provisions should further a greater degree of independent decision-making by the governing body of an exchange or association.

The proposed rules would require exchanges and associations to explicitly mandate that each director, in discharging his or her responsibilities as a member of the board, reasonably consider all requirements applicable to the exchange or association under the Exchange Act.[623] The Commission believes that this requirement would benefit investors, members, and other users of the facilities of the exchange or association by helping to ensure that directors of exchanges and associations fully recognize that the exchange or association has certain obligations under the Exchange Act, and that the directors act in accordance with those obligations. In particular, explicitly requiring directors to take into account the exchange's or association's obligations under the Exchange Act should help promote greater awareness and accountability on the part of directors about the responsibilities of the exchange or association, thus furthering the objectives of the Exchange Act.

Moreover, the Commission believes that the proposals to separate the regulatory operations of an exchange or association, and any regulatory subsidiary, from its market operations and other commercial interests,[624] to require regulatory funds to be applied only to fund programs and operations directly related to the exchange's or association's regulatory responsibilities,[625] and to require an exchange or association to establish procedures to prevent the dissemination of regulatory information other than to persons carrying out the exchange's or association's regulatory obligations,[626] should allow SROs to better manage the conflicts of interest inherent in the self-regulatory structure between the SRO's regulatory responsibilities and its market operations.[627] These provisions of the proposed governance rules would help promote greater accountability on the part of exchanges and associations with respect to their regulatory programs and strengthen their ability to meet their statutory obligations.

In particular, the proposal to require an exchange or association to use funds collected from regulatory fees, fines or penalties only to fund programs and operations directly related to the exchange's or association's regulatory responsibilities is designed to diminish the potential for an exchange or association to use its authority to raise regulatory funds for the purpose of benefiting its shareholders, or for other non-regulatory purposes, such as to fund executive compensation. The Commission believes that the proposed requirements to use regulatory funds only to fund regulatory activities would further advance the SROs' ability to effectively comply with statutory requirements, by helping to ensure that an SRO's regulatory activities are properly funded and the SRO is not abusing its regulatory authority.

The proposed rules also would require an exchange or association to establish policies and procedures reasonably designed to maintain the confidentiality of information required to be submitted to effectuate a transaction on or through the facilities of an exchange or association.[628] The proposed rules also would require that an exchange's or association's policies and procedures to be designed to reasonably prevent the dissemination of information collected from its members in the course of performing its regulatory obligations under the Exchange Act (''regulatory information'') to any person that is not an officer, director, employee, or agent of the exchange or association directly involved in carrying out the exchange's or association's regulatory obligations under the Exchange Act, and would prohibit an exchange or association from using regulatory information other than for regulatory purposes.[629] By helping to ensure that regulatory information is only used for regulatory purposes, the Commission believes that these proposed requirements would benefit investors and the public by helping to maintain the independence of an exchange's or association's self-regulatory function, thus furthering the ability of the exchange or association to carry out its regulatory responsibilities in compliance with the Exchange Act. In addition, because the proposed rules

[619] See proposed Rules 6a–5(f)(4) and 15Aa–3(f)(4).

[620] *See* proposed Rules 6a–5(m)(1) and 15Aa–3(m)(1).

[621] *See* proposed Rules 6a–5(m)(2) and (4) and 15Aa–3(m)(2) and (4).

[622] *See* proposed Rules 6a–5(m)(3) and 15Aa–3(m)(3). *See supra* Section II.B.7. for a discussion of these proposed rules.

[623] *See* proposed Rules 6a–5(l)(2) and 15Aa–3(l)(2). *See supra* Section II.B.5. for a discussion of this proposed requirement.

[624] *See* proposed Rules 6a–5(n)(1) and 15Aa–3(n)(1).

[625] *See* proposed Rules 6a–5(n)(4) and 15Aa–3(n)(4).

[626] *See* proposed Rules 6a–5(n)(5) and 15Aa–3(n)(5).

[627] *See supra* Section II.B.8. for a discussion of these proposed rules.

[628] *See* proposed Rule 6a–5(n)(5)(i)(C) and 15Aa–3(n)(5)(i)(C). This requirement would not apply if such information is aggregated to such an extent that no person whose information is included in the aggregated information can be identified, or unless the person has consented to the dissemination and use of its information by the exchange.

[629] *See* proposed Rules 6a–5(n)(5)(A) and (B) and 15Aa–3(n)(5)(A) and (B). *See supra* Section II.B.8.c. for a discussion of this proposed requirement.

would help to assure members that any information they provide to the exchange or association for regulatory purposes would not be used for competitive or other non-regulatory purposes, it would facilitate the provision of information to the exchange or association that would help the exchange or association carry out its regulatory obligations under the Exchange Act.

The proposed governance rules also would require the rules of an exchange or association to prohibit any member that is a broker or dealer, either alone or together with its ''related persons,'' from directly or indirectly beneficially owning and voting any interest in the exchange, the association, or a facility of an exchange or association through which the member is permitted to effect transactions, that exceeds 20% of any class of securities or other ownership interest of the exchange, association, or facility.[630] This proposed requirement would serve to mitigate the conflict of interest that could occur if a broker-dealer were to control a significant interest in its regulator. For example, an ownership and voting limit would reduce the ability of a member to influence the regulatory operation of the exchange or association for its benefit (such as by directing the exchange to refrain from diligently surveilling the member's conduct or from punishing conduct that violates the rules of the exchange or the federal securities laws). In addition, imposing such a limitation would make it more difficult for a member to direct or affect the business of an exchange or association to enhance its own commercial interests. Thus, the Commission believes that requiring exchanges and associations to impose ownership and voting limits on members could benefit investors and the public by reducing the risk that a member could use its controlling interest in its regulator to influence the regulatory process to its benefit.

The Commission believes that it is important that there be sufficient independence within the self-regulatory process to adequately check undue interference or influence from the persons or entities being regulated. These proposed rules, individually and as a whole, would help insulate the regulatory activities of an exchange or association from the conflicts of interest that may otherwise arise by virtue of its market operations. The independence of the regulatory process would be further strengthened through the appointment of a Chief Regulatory Officer who would administer the regulatory program and who would report directly to the independent Regulatory Oversight Committee.

The Commission believes that requiring exchanges and associations to adopt a code of conduct and ethics should help foster the ethical behavior of directors, officers and employees, because these individuals would be informed of the standards of conduct expected of them in fulfilling the responsibilities of their positions. Similarly, requiring exchanges and associations to adopt governance guidelines should help promote greater awareness of the governance principles that are intended to guide the exchange or association in implementing good governance.

2. Costs

The Commission anticipates that proposed Rules 6a–5 and 15Aa–3 would impose costs on exchanges and associations. Moreover, because the proposed governance rules also would apply to regulatory subsidiaries of the exchange or association, exchanges and associations would incur additional costs related to compliance by these entities with the proposed rules. Exchanges and associations not currently in compliance with the proposed governance rules would need to spend time and incur costs in modifying their internal processes and operations, as well as taking necessary steps to amend their rules, including their charters and bylaws, to comply with any new standards. Changes also would need to be made to the internal processes and operations, and rules, including charters and bylaws, of any regulatory subsidiaries or facility of the exchange or association to the extent the exchange or association would be required to apply the rules to those entities. Exchanges and associations would have to file with the Commission under Section 19(b) of the Exchange Act[631] proposed rule changes that would contain new rules or rule amendments that comply with the proposed governance rules. Modifying internal processes, drafting new charter, bylaw, and rule provisions, and preparing proposed rule changes to file with the Commission would impose costs on exchanges and associations, although some, if not all, SROs most likely would rely on in-house legal staff to perform these tasks. The Commission seeks comment on these costs.

Exchanges and associations that do not already have a board composed of a majority of independent directors would incur additional costs in modifying the composition of their boards. An exchange or association could comply with the majority independent board requirement by decreasing the size of its board and allowing some non-independent directors to resign; maintaining the current size of its board and replacing some non-independent directors with independent directors; or by increasing the size of its board and electing additional independent directors. In any event, unless an exchange or association currently complies with the proposed standards, it would incur costs in adding new directors or replacing existing directors. If an exchange or association elects to add independent directors to comply with the proposed requirement for a majority independent board, it could incur costs in finding qualified candidates that fit the proposed independence criteria. An exchange or association also could incur costs associated with preparing, as well as administering and reviewing, questionnaires to be completed by a director to determine whether such director could be considered independent. As discussed above in Section IX, the Commission estimates that each exchange or association would annually spend 34 hours and $12.58 if it were to request information from its directors regarding their independence, resulting in a total annual reporting and recordkeeping burden of approximately 340 hours and approximately $126 for all exchanges and associations.

Exchanges and associations that do not already have an independent Chairman, in the event that the Chairman and CEO are two individuals, could incur additional costs in hiring and compensating a new Chairman. An exchange or association could elect to name a current independent member of the board as Chairman; however, such a move would still likely impose compensation costs, in addition to costs incurred in changing leadership. Also, when modifying the composition of their boards, exchanges and associations could incur additional costs associated with preparing, mailing and processing proxy or information statements that would be necessary to hold a meeting to elect new directors. The Commission seeks comment on these costs.

In addition, exchanges and associations could have additional costs in adjusting to new board practices and providing independent directors with the necessary funding and resources to

[630] *See* supra Section II.B.9. for a discussion of proposed Rules 6a–5(o) and 15Aa–3(o).

[631] 15 U.S.C. 78s(b)(1).

carry out their duties.[632] For example, the proposed rules would require that independent directors meet regularly in executive session.[633] In addition, independent directors would be permitted to hire and obtain advice and assistance from independent legal counsel and other advisors as they determine necessary to carry out their duties.[634] The Commission seeks comment on these costs.

The proposed governance rules also would require exchanges and associations to administer a fair process that provides members with the opportunity to select at least 20% of the total number of directors.[635] Further, the Nominating Committee would be required to nominate at least one director who is representative of issuers and at least one director who is representative of investors and who, in each case, is not associated with a member or broker or dealer.[636] These proposed provisions are intended to codify in rules the fair representation requirements set forth in the Exchange Act.[637] Some SROs currently may be in compliance with these proposed requirements because they are commensurate with statutory standards that SROs currently must satisfy. However, the Commission requests comment concerning whether exchanges and associations would incur additional costs to comply with the specific requirements set forth in the proposed rules.

The proposed governance rules would require that each Standing Committee be composed entirely of independent directors;[638] that each Standing Committee perform an annual self-evaluation, except that the Governance Committee would perform an annual evaluation of the governance of the exchange or association as a whole;[639] and that each Standing Committee be provided sufficient funding and other resources, as determined by each Standing Committee, to permit it to retain independent legal counsel and other advisors.[640] The exchange or association could incur costs to organize board functions along the lines of the proposed Standing Committees. As noted above, an exchange or association could incur costs to add independent directors to its board, but there should not be any costs incurred as a result of appointing those independent directors to serve on Standing Committees. Similarly, the Commission does not believe that costs would be incurred in connection with the annual performance evaluation by each Standing Committee, unless such Standing Committee had to hire new employees or outside advisors to perform the evaluation. However, to the extent that the proposal causes an increase in the duties of board committee members, and a corresponding increase in the amount of time that directors spend fulfilling their committee obligations, exchanges and associations could find that there are additional costs in compensating directors for their duties. The Commission requests comment on the likelihood of this scenario. Further, to the extent that current funding is not sufficient to permit the independent directors to retain independent legal counsel and other advisors, an exchange or association could incur additional costs in providing such funding. The Commission seeks comment on these costs.

The proposed governance rules would require exchanges and associations to establish policies and procedures to assure the independence of their regulatory program from the operation or administration of any market operations and other commercial interests.[641] To this end, the proposed governance rules would require that the exchange's or association's regulatory program either be structurally separated from its market operations and other commercial interests or functionally separated but contained within the same entity.[642] In either case, the proposed governance rules would require that the board appoint a Chief Regulatory Officer to administer the regulatory program and that the Chief Regulatory Officer report directly to the independent Regulatory Oversight Committee.[643] The Commission seeks comment on these costs.

An exchange or association that undertakes a structural separation of its regulatory program from its market operations and other commercial interests through the creation of a new separate legal entity would incur costs associated with the formation or incorporation of such new entity, as well as costs associated with hiring and compensating individuals to manage such new entity. An exchange or association that undertakes to functionally separate its regulatory program from its market operations and other commercial interests also would incur additional costs associated with analyzing the exchange's or association's current regulatory practices and modifying such practices to comply with the proposed governance rules. Unless an exchange or association currently employs a Chief Regulatory Officer, the Commission expects that exchanges and associations would incur costs associated with hiring and compensating a Chief Regulatory Officer. The Commission seeks comment on these costs.

The Commission recognizes that an exchange or association could incur costs to establish policies and procedures necessary to segregate regulatory funds and to keep books and records necessary to demonstrate compliance with the proposed requirement to use regulatory funds only to fund programs and operations directly related to the exchange's or association's regulatory responsibilities.[644] The Commission preliminarily believes that those funds should be readily identifiable, and that exchanges and associations likely already segregate certain funds derived from regulatory fees, fines and penalties. To the extent that exchanges and associations do not already segregate regulatory funds, they would have to modify their existing financial controls to assure that they operate in compliance with the proposed requirement. The Commission seeks comment on whether exchanges and associations currently segregate regulatory funds, or can easily identify such funds, and the costs that would be incurred to make modifications. The Commission also seeks comment on whether exchanges and associations would have to put in place new financial controls, or whether the existing financial controls of an exchange or association are sufficient to assure that it operates in compliance with the proposed rules.

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[632] *See* proposed Rules 6a–5(d)(3) and 15Aa–3(d)(3).

[633] *See* proposed Rules 6a–5(d)(1) and 15Aa–3(d)(1).

[634] *See* proposed Rules 6a–5(d)(2) and 15Aa–3(d)(2).

[635] *See* proposed Rules 6a–5(c)(4) and (f)(3) and 15Aa–3(c)(4) and (f)(3).

[636] *See* proposed Rule 6a-5(f)(4) and 15Aa-3(f)(4).

[637] *See* 15 U.S.C. 78f(b)(3) and 15 U.S.C. 78o-3(b)(4).

[638] *See* proposed Rules 6a–5(f)(1), (g)(1), (h)(1), (i)(1) and (j)(1) and 15Aa–3(f)(1), (g)(1), (h)(1), (i)(1) and (j)(1).

[639] *See* proposed Rules 6a–5(f)(5), (g)(3), (h)(3), (i)(3) and (j)(6) and 15Aa–3(f)(5), (g)(3), (h)(3), (i)(3) and (j)(6).

[640] *See* proposed Rules 6a–5(e)(3) and 15Aa–3(e)(3).

[641] *See* proposed Rules 6a–5(n)(1) and 15Aa–3(n)(1).

[642] *See* proposed Rules 6a-5(n)(2) and 15Aa–3(n)(2).

[643] *See* proposed Rules 6a–5(n)(3) and 15Aa–3(n)(3).

[644] *See supra* Section II.B.8.b. for a discussion of proposed Rules 6a–5(n)(4) and 15Aa–3(n)(4).

The Commission also recognizes that an exchange or association could incur costs to establish the policies and procedures reasonably designed to prevent the dissemination of regulatory information to any person not directly involved in carrying out the exchange's or association's regulatory obligations under the Exchange Act, and to keep certain other transaction-related information confidential, unless made available in aggregated form.[645] As part of their existing policies to comply with their obligations under the Exchange Act, the Commission believes that exchanges and associations already have policies and procedures designed to safeguard and restrict the use and dissemination of such information. Therefore, the Commission preliminarily believes that exchanges and associations would not need to expend substantial resources to modify their internal processes to comply with the proposed requirements. The Commission requests comment from exchanges and associations as to whether the measures they employ, if any, to safeguard and restrict the use and dissemination of confidential information currently comply with the proposed requirements, or whether exchanges and associations will need to modify their internal processes. An exchange or association also could incur costs in taking action necessary to assure that its officers, directors, employees and agents agree to comply with the proposed requirements (as required by the proposed rules),[646] and to educate new, as well as existing, employees about these requirements. The Commission seeks comment on the extent of these identified costs.

While the Commission believes that members of the boards of exchanges and associations already consider the Exchange Act responsibilities of the exchange or association in the course of performing their duties, the Commission recognizes that an exchange or association would incur costs necessary to amend its rules to explicitly require its directors to reasonably consider its Exchange Act responsibilities when discharging their responsibilities as members of the board.[647] The exchange or association also would incur costs necessary to inform its current board members of the rule and their obligations, and to inform new board members. The Commission seeks comment on these costs.

The Commission recognizes that exchanges and associations (and their facilities) likely would incur costs associated with establishing and enforcing rules to effectuate the proposed ownership and voting limits on members that are brokers or dealers. These costs could include exchange or association staff resources and legal fees related to drafting, preparing, and filing proposed rule changes with the Commission. The costs also would include staff resources, legal and filing fees related to filing corporate governing documents with the exchange's, association's or facility's state of incorporation. The Commission also recognizes that an exchange or association might need to obtain the approval of its members or shareholders, or of the owners of its facility, to implement such rules, which could require the exchange or association to prepare a proxy statement. The costs that would be required to obtain the necessary approval of any required change would depend on the number of such persons, the ownership concentration of the exchange, association or facility, and such persons' receptiveness to the proposed rules. In addition, corporate law might require the exchange or facility to notify its shareholders or owners of any ownership or voting restrictions by either sending a notice or by inserting a legend on the stock or ownership certificates. The Commission seeks comment on these costs.

The Commission also recognizes that exchanges and associations would incur ongoing costs associated with obtaining ownership information and monitoring the ownership interests of members for compliance with the proposed ownership and voting limits. Facilities also could incur these costs to the extent the exchange or association requires the facility's help to obtain and monitor ownership by members and their related persons in the facility. As stated above in Section IX., the Commission estimates that an exchange or association would spend approximately 14 hours and $1,290 annually if it determined to request ownership information from owners of voting and ownership interests. Thus, the Commission estimates that all exchanges and associations annually would spend a total of approximately 140 hours and $12,900 if they requested such ownership information. The Commission requests comment on this estimate. In addition, an exchange or association, as well as a facility, could incur costs of enforcing the ownership and voting limits. For example, an exchange could incur costs involved with redeeming shares held in excess of the proposed limits if the exchange chooses to provide that any such excess shares would be purchased by the exchange. An exchange, association or facility also could incur costs associated with monitoring votes cast at any shareholder meeting to determine that no member and its related persons subject to the voting limits exceeded those limits.

Any member and its related persons that owns in excess of the proposed limit of any class of securities or other ownership interest of the exchange, association, or facility could incur costs involved with divesting the portion of its ownership interest that exceeds the limit. As stated above in Section IX., the Commission preliminarily believes that only two members that are brokers or dealers currently own greater than 20% of a demutualized exchange or facility.[648] The Commission specifically requests comment on this issue, and whether any other broker-dealer members (alone or together with their related persons) currently own more than 20% of an SRO or a facility of an SRO. The Commission also recognizes that implementation of the proposed ownership and voting restrictions on members that are brokers or dealers potentially could reduce the value of the ownership interests in the exchange, association, or facility, to the extent that the proposed requirements adversely affect the free transferability of the securities, which would impact the owner of the securities, as well as the exchange, association, or facility. The Commission seeks comment on these costs.

Finally, the proposed governance rules would require each exchange and association to adopt a code of conduct and ethics for directors, officers and employees, as well as governance guidelines that include specified provisions.[649] Some exchanges or associations could already have codes and guidelines that comply with the proposed governance rules, in which

[645] *See supra* Section II.B.8.c. for a discussion of proposed Rules 6a–5(n)(5) and 15Aa–3(n)(5).

[646] *See* proposed Rules 6a–5(o)(5) and 15Aa–3(o)(5).

[647] *See supra* Section II.B.5. for a discussion of proposed Rules 6a–5(l)(2) and 15Aa–3(l)(2).

[648] At the time that the Commission approved BOX as a trading facility of BSE, Interactive Brokers Group LLC (a registered broker-dealer) owned more than a 20% interest in BOX. *See* Securities Exchange Act Release No. 49067, *supra* note 59. Also, at the time the Commission approved a PCX rule filing relating to the IPO of Archipelago Holdings, one member of PCX held both an equity trading permit issued by PCX Equities and more than a 20% interest in Archipelago Holdings. *See* Securities Exchange Act Release No. 50170, *supra* note 65.

[649] *See supra* Section II.B.10. for a discussion of the proposed code of conduct and ethics and governance guidelines.

case, little or no costs would be incurred. However, other exchanges or associations may be required to utilize in-house staff or hire legal counsel to draft such codes or guidelines. The Commission requests comment on the extent to which exchanges and associations already have codes and guidelines that comply with the proposed rules.

3. Request for Comment

The Commission generally requests comment as to whether the operation of proposed Rules 6a–5 and 15Aa–3 would result in the potential costs discussed above, and how to quantify these potential costs. In addition, the Commission requests data to quantify the costs and benefits described above. The Commission seeks estimates of these costs and benefits, as well as any costs and benefits not already defined, which may result from the adoption of these proposed new rules.

B. Costs and Benefits of Proposed Regulation AL

As discussed above, the listing of securities issued by an SRO, the facility of an SRO, or an affiliate of either (''affiliated securities'') on the SRO raises questions as to the SRO's ability to independently and effectively enforce its rules against itself.[650] For instance, the 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 its market even if the security is not in full compliance with the SRO's listing rules. The trading of securities of an SRO or the securities of an affiliated issuer on the SRO also raises similar potential conflict concerns, in that 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. For example, the SRO may determine to look the other way with respect to improper trading in an affiliated security that creates the appearance of increased volume, such as through wash sales, or trading that artificially inflates or sustains the price of the stock, such as marking the close.

Proposed Regulation AL would prohibit an exchange or association from approving for listing an affiliated security unless such exchange's or association's Regulatory Oversight Committee (composed of independent directors) certified that such security satisfies the exchange's or association's rules for listing.[651] Proposed Regulation AL also would impose reporting and notice requirements on an exchange or association with respect to an affiliated security.[652] Specifically, an exchange or association would have to file quarterly reports with the Commission regarding its monitoring of the listing and trading of an affiliated security on its market; on an annual basis provide the Commission a copy of a report prepared by a third party analyzing compliance by the affiliated security with the exchange's or association's listing rules; promptly notify an affiliated issuer of alleged non-compliance with a listing rule; provide the Commission with a report detailing such alleged non-compliance; and provide the Commission with a copy of any response from the affiliated issuer.[653] The exchange's or association's Regulatory Oversight Committee would have to approve the quarterly reports and the report detailing non-compliance.

1. Benefits

The Commission believes that requiring an exchange's or association's Regulatory Oversight Committee to have a role in monitoring compliance with the exchange's or association's rules with regard to an affiliated security would reduce the potential for conflict between an exchange's or association's self-regulatory responsibility to vigorously oversee the listing and trading of the affiliated security on its market, and its own commercial or economic interests. In particular, requiring the Regulatory Oversight Committee—a fully independent committee—to certify that an initial listing of an affiliated security satisfies the listing rules would bring a level of independence to the process. Also, requiring the Regulatory Oversight Committee to approve the quarterly reports and reports detailing non-compliance prior to filing with the Commission would serve to bring independent oversight to the ongoing monitoring process, and provide the Regulatory Oversight Committee with timely notice of potential concerns. In addition, the Commission believes that requiring a third party to analyze compliance with listing rules would serve to add an additional layer of impartiality to the oversight process. Regulation AL also would require the exchange or association to apply its listing rules to affiliated securities in a manner that is not materially different than the treatment afforded to other securities listed on the exchange or association, and that any action taken by the exchange or association with respect to listing and trading of an affiliated security be in compliance with the rules of the exchange or association. The Commission believes that these steps would help to address the potential conflict of interest, which would benefit investors and the market generally by helping to prevent fraud and manipulation and by helping to ensure that the exchange or association does not give preferential treatment to affiliated securities.

2. Costs

Each exchange or association already should have in place established policies and procedures for monitoring the listing and trading of securities on or through its facilities.[654] The Commission believes that the monitoring of the listing and trading of an affiliated security should fall within these existing procedures, thus minimizing costs necessary to monitor the listing and trading of an affiliated security's compliance with proposed Regulation AL.

The Commission recognizes that each exchange or association that lists an affiliated security could incur costs associated with a more frequent review for compliance with listing rules if the exchange or association does not perform such review at least once a quarter. As stated above in Section IX., the Commission estimates that an exchange or association that does not review for compliance on a quarterly basis would incur an additional reporting and recordkeeping burden of 8 hours per review, and further estimates that two additional reviews per year would be required. The Commission's preliminary belief, however, is that each exchange and association already performs some level of review for compliance with its listing rules on at least a quarterly basis. The Commission requests comment on this issue.

In addition, the exchange or association could incur costs associated with requiring the Regulatory Oversight Committee to certify the initial listing of the affiliated security, and to approve each quarterly and any non-compliance reports, because the Committee would need time to review the listing rules and reports. An exchange or association also would incur in-house legal, compliance

[650] *See supra* Section III. for a discussion of proposed Regulation AL.

[651] *See* proposed Rule 800(b)(1).

[652] *See* proposed Rule 800(b)(2)

[653] *See id.*

[654] The Commission notes that an exchange or association only would incur costs necessary to comply with proposed Regulation AL if it approved for listing an affiliated security that is to be traded on or through its facilities.

and administrative costs related to preparing and filing quarterly reports with the Commission and, if an exchange or association were to allege that an affiliated security was not in compliance with listing rules, with preparing and filing a report with the Commission detailing such alleged non-compliance.[655] As discussed above in Section IX., the Commission estimates that each exchange or association would spend approximately 17 hours preparing and filing the initial quarterly report and 12 hours for each quarterly report thereafter, for a total of 53 hours per exchange or association for the first year and 48 hours per exchange or association thereafter. Additionally, the Commission estimates that each exchange or association would spend approximately 5 hours to prepare and file a non-compliance report, 2 hours to notify an issuer of alleged non-compliance, 2 hours to comply with the proposed requirement to file a copy with the Commission of a response to any issuer that notifies the exchange or association of alleged non-compliance and $1.29[656] each time the exchange or association notifies an issuer of alleged non-compliance, files a report with the Commission, sends notice of non-compliance to an issuer or files a copy with the Commission of any notice of non-compliance. The Commission is not able to estimate how many non-compliance reports would need to be filed, how many times an exchange or association would need to notify an issuer of non-compliance, and how many times an exchange or association would need to file a copy with the Commission of any response to any issuer that notifies the exchange or association of its non-compliance, but estimates that one occurrence of each such event per exchange or association would occur each year. Accordingly, the Commission estimates that each exchange or association would spend 9 hours per year and $3.87, for a total of 81 hours and approximately $35 for all exchanges and associations.

In addition, the exchange or association would incur the costs of hiring a third party to analyze and prepare a report regarding the affiliated security's compliance with the exchange's or association's listing rules on an annual basis.[657] The Commission also estimates that an exchange or association would spend approximately 9 hours reviewing and participating in the preparation of such third party reports. As discussed above in Section IX., the Commission preliminarily estimates that it would take a third party approximately 22 hours to prepare and file each report, for a total annual cost per exchange or association of approximately $6,612, or $59,508 annually for all exchanges and associations.

3. Request for Comment

The Commission seeks comment on any additional benefits of proposed Regulation AL. The Commission also generally requests comment as to whether the operation of the proposed rule would result in the potential costs discussed above, and how to quantify these potential costs. The Commission also seeks comment on any additional anticipated costs and benefits of the proposed rule, including specifics of the dollar amount of such cost or benefit impact.

C. Costs and Benefits of Proposed Rule 6a–2 and Revised Form 1, and Rule 15Aa–2 and New Form 2

The Commission proposes to amend the procedures for application as a national securities exchange (or exchange exempt from registration based on limited volume) or registered securities association (or affiliated securities association), and for the submission of amendments to such applications. In addition, the proposals would harmonize the disclosure requirements for exchanges and associations.

Under the proposals, an applicant for registration as a national securities exchange or an exchange exempt from registration pursuant to Section 5 of the Exchange Act,[658] or as a registered securities association or an affiliated securities association, would be required to submit a registration statement and provide disclosure to the Commission on revised Form 1 (for exchanges) or new Form 2 (for associations).[659] Any exchange or association that is registered with the Commission as of the publication date of adoption of any proposed amendments to the forms would be required to file a complete registration statement on revised Form 1 or new Form 2, as applicable, within six months following such publication date. Exchanges and associations also would use revised Form 1 and new Form 2, respectively, to submit amendments. An exchange or association further would be required to comply with proposed amendments to Rule 6a–2[660] and revised Form 1, and proposed Rule 15Aa–2 and new Form 2, on behalf of any facility that is a separate legal entity[661] or any regulatory subsidiary of the exchange or association with respect to the filing of specified Exhibits.[662] The term ''regulatory subsidiary'' would mean any person that, directly or indirectly, is controlled by the exchange or association and that provides, whether pursuant to contract, agreement or rule, regulatory services to or on behalf of the exchange or association.[663]

The Commission's proposals would require the disclosure of greater information about exchanges and associations, particularly with respect to their governance and organizational structure, their regulatory programs, and significant ownership of the exchange or association or facility of the exchange or association.[664] Under the Commission's proposals, certain Exhibits to the current Form 1 (exchanges) would be revised to require more detailed disclosures; comparable disclosures would be required pursuant to Form 2 (associations). These revised Exhibits

[655] The exchange or association may also incur outside legal costs, to the extent they choose to outsource the preparation of these reports. The Commission does not believe it likely that an exchange or association would outsource the preparation of these reports, but requests comment on the issue.

[656] The Commission assumes that each report and notification will weigh five ounces and will be mailed via first class mail at a rate of $0.37 for the first ounce and $0.23 for each additional ounce, for a total of $1.29.

[657] The Commission believes that most, if not all, exchange and association listing rules include fairly objective quantitative (*e.g.* market capitalization) and qualitative (*e.g.* that the majority of the board be independent) listing standards. For example, *see* Sections 1 and 3 of the NYSE *Listed Company Manual* and Rules 4300, *et seq.*, of the NASD Manual.

[658] 15 U.S.C. 78e.

[659] Currently, securities associations are required to register on Form X–15AA–1 and to file amendments and supplements on Forms X–15AJ–1 and X–15AJ–2. The Commission proposes to redesignate Form X–15AA–1 as Form 2 and to amend Form 2 in a manner consistent with the proposals contained in this release. For clarity, we refer to the registration form for exchanges, as proposed to be amended, as ''revised Form 1'' and the registration form for securities associations, as proposed to be redesignated and amended, as ''new Form 2.''

[660] 17 CFR 240.6a–2.

[661] The term ''facility'' when used with respect to an exchange would have the same meaning as in Section 3(a)(2) of the Exchange Act. 15 U.S.C. 78c(a)(2). The term ''facility'' when used with respect to an association is defined in proposed Rule 15Aa–3(b)(11).

[662] The proposed Exhibits to revised Form 1 and new Form 2 for which an exchange or association would need to include information with respect to a facility or regulatory subsidiary are Exhibits A (governance documents and rules), B (written rulings, interpretations), C (composition, structure and responsibilities of the board), D (list of officers), E (information about executive board and committees), F (governance guidelines, code of conduct and ethics (and waivers), G (internal organizational charts), H (regulatory program), and I (financial information).

[663] *See* proposed Instructions to revised Form 1 and new Form 2.

[664] *See supra* Section IV.

would pertain to information about the officers of exchanges and associations;[665] a description of the structure, composition, and responsibilities of any executive board and each committee;[666] financial information, including an itemization of revenues and expenses;[667] the ownership interest of any exchange, association, or facility of an exchange or association, and information on persons owning more than 5% of such ownership interest;[668] and information about securities listed or traded on the SRO or on any SRO trading facility.[669] In addition, the Commission is proposing to add several new Exhibits to the current Form 1 and to incorporate those Exhibits in new Form 2. These Exhibits would pertain to the composition, structure, and responsibilities of the board;[670] the governance guidelines, code of conduct and ethics (and waivers thereof),[671] and the method established by the exchange or association for interested parties to communicate their concerns regarding any matter within the authority or jurisdiction of a Standing Committee directly to independent directors;[672] the organizational structure of the exchange or association;[673] the regulatory program of the exchange or association;[674] the relationship between and among the exchange (or association), any facility of an exchange (or association), and any affiliate of the exchange (or association) or facility of the exchange (or association);[675] and the location of the exchange's or association's books and records.[676]

One of the most significant proposed features is the requirement that exchanges and associations provide more in-depth disclosures about their regulatory programs and a breakdown of the revenues and expenses associated with those programs. Exchanges and associations would need to provide a description of their regulatory programs (and those of any regulatory subsidiary). The description would include information concerning member firm regulation, market surveillance, enforcement, listing qualifications, arbitrations, rulemaking and interpretation, and the process for assessment and development of regulatory policy. Exchanges and associations would be required to provide a copy of any delegation plan or other contract or agreement relating to regulatory services that are provided or will be provided to the exchange or association by another SRO, a regulatory subsidiary, or a regulatory subsidiary of another SRO. Exchanges and associations also would be required to describe fully the method established by the board for interested parties to communicate their concerns regarding any matter within the authority or jurisdiction of a Standing Committee directly to independent directors.[677]

Further, revised Form 1 and new Form 2 would require the exchange or association to provide a description of the structural or functional independence of the regulatory program from the market operations and other commercial interests of the exchange or association, and to discuss fully any significant regulatory issues that have arisen or any significant events that have taken place in the past year and the effect these significant issues or events may have on the mission, strategy, and future operations of the exchange's or association's regulatory program.[678]

In addition, the proposals would require exchanges and associations to disclose their regulatory expenses as a proportion of their total budget, and separately as a proportion of their total annual revenues. Pursuant to this provision, exchanges and associations would be required to disclose the aggregate amounts that they expend on regulatory activities, as well as the amounts that they expend on certain subcategories of regulatory activities, including supervisory activities (*e.g.*, routine examinations and oversight of member activity conducted in the regular course of business), surveillance activities (*e.g.*, manual and automated surveillance to ensure compliance with rules, such as trading rules and financial responsibility rules), and disciplinary activities (*e.g.*, enforcement activities). Revised Form 1 and new Form 2 also would require exchanges and associations to disclose the dollar amount of their revenues and expenses of their regulatory programs, with detailed itemization within the following broad categories: revenues; direct expenses; and allocated expenses. Exchanges and associations would provide this information for each area of their regulatory programs, such as surveillance, supervision, and discipline, and provide aggregate data for all program areas.[679]

Further, the proposals would require exchanges and associations to amend Form 1 and Form 2 closer in time to the occurrence of an event that requires amendment.[680] The Commission also is proposing to require that each exchange and association prepare annually an updated Form 1 or Form 2, as applicable,[681] and continuously post its most recent form and any subsequent amendments on a publicly accessible Internet Web site controlled by the exchange or association.[682] The proposed amendments would give exchanges and associations the option of complying with the annual filing requirements for specified Exhibits by posting the required information on an Internet Web site and certifying that the posted information is accurate.[683]

1. Benefits

By requiring that national securities exchanges (and exchanges exempted from registration based on limited volume) and registered securities associations (and affiliated securities association) to provide equivalent information on revised Form 1 (exchanges) and new Form 2 (associations), the Commission expects that the proposals would benefit an exchange's or association's members, users of their facilities, institutional and retail investors, and the shareholders or other owners of the exchange or association, as well as the Commission, by providing them with access to more frequent and more detailed information about aspects of exchanges' and associations' governance and organizational structures, their regulatory programs, and their significant owners. Further, the proposals are intended to align the

[665] *See* proposed Exhibit D to revised Form 1 and new Form 2.

[666] *See* proposed Exhibit E to revised Form 1 and new Form 2.

[667] *See* proposed Exhibit I to revised Form 1 and new Form 2.

[668] *See* proposed Exhibit Q to revised Form 1 and new Form 2.

[669] *See* proposed Exhibit T to revised Form 1 and new Form 2. The term ''SRO trading facility'' would mean any facility of a national securities exchange or registered securities association that executes orders in securities. *See* proposed Instructions to revised Form 1 and new Form 2.

[670] *See* proposed Exhibit C to revised Form 1 and new Form 2.

[671] *See* proposed Exhibit F to revised Form 1 and new Form 2.

[672] *See* proposed Exhibit C to revised Form 1 and new Form 2.

[673] *See* proposed Exhibit G to revised Form 1 and new Form 2.

[674] *See* proposed Exhibit H to revised Form 1 and new Form 2.

[675] *See* proposed Exhibit P to revised Form 1 and new Form 2.

[676] *See* proposed Exhibit U to revised Form 1 and new Form 2.

[677] *See* proposed Exhibit C to revised Form 1 and new Form 2.

[678] *See* proposed Exhibit H to revised Form 1 and new Form 2.

[679] *See* proposed Exhibit I to revised Form 1 and new Form 2.

[680] *See* proposed Rules 6a–2(a) and 15Aa–2(a).

[681] *See* proposed Rules 6a–2(b) and 15Aa–2(b).

[682] *See* proposed Rules 6a–2(c) and 15Aa–2(c).

[683] *See* proposed Rules 6a–2(d) and 15Aa–2(d).

regulatory disclosure framework for exchanges and associations by mandating comparable disclosure requirements for both types of SROs, particularly as they are charged with nearly identical obligations under the Exchange Act.[684] The Commission also believes that disclosure of information with respect to the facility or regulatory subsidiary of an exchange or association would provide benefits to investors, market participants, and others by providing a more accurate and complete overview of the structure and governance of an SRO.

In the Commission's view, the proposed amendments to Rule 6a–2 and new Rule 15Aa–2, along with revised Form 1 and new Form 2, should bring a much greater degree of transparency to the administration, organization, governance, and ownership of exchanges and associations than currently exists. The Commission and the public would have access to more detailed information about the board members, officers, and committee members of exchanges and associations; the structure, composition, and responsibilities of the board, executive board, and each committee; financial information, including an itemization of revenues and expenses; the ownership interest of any exchange, association, or facility of an exchange or association, and information on persons owning more than 5% of such ownership interest; and information about securities listed or traded on the SRO or on any SRO trading facility. In addition, the Commission and the public would be able to obtain information about the governance guidelines, waiver of the code of conduct and ethics, and method by which interested parties may communicate concerns to independent directors with respect to a Standing Committee; the organizational structure of the exchange or association; the regulatory program of the exchange or association; the relationship between and among the SRO, its facilities, and any affiliate of the SRO or a facility of the SRO; and the location of the exchange's or association's books and records.

These enhanced disclosure requirements would enable a wide range of individuals and entities, including members of exchanges and associations, users of their facilities, institutional and retail investors, other market participants, shareholders and other owners of demutualized exchanges or facilities and the public generally, as well as regulators, to have access to important information about exchanges and associations. Such specific, detailed disclosure requirements would further the goal of providing market participants, investors, and the public generally with disclosures by SROs that present a greater degree of clarity and transparency. As SROs, exchanges and associations are accorded a public trust to oversee their markets and members and to protect investors and the public interest. The proposed disclosure requirements are intended to shed more light on those aspects of an SRO that are central to its carrying out its obligations under the Exchange Act.[685] Thus, the proposed disclosure requirements should enhance investors' confidence in the fairness and integrity of the securities markets by requiring exchanges and associations to provide specific disclosures about their governance and administration.

The proposed disclosure requirements also should benefit exchanges and associations because they would require these SROs to periodically focus on their governance structures and regulatory programs, as well to identify their significant owners, when they prepare the annual updates to Forms 1 and 2. Moreover, the proposals would provide the Commission with access to a stream of important information about exchanges and associations that could be used for oversight purposes. For instance, requiring an SRO to report on persons that own more than 5% of the SRO or its facilities would serve to focus the SRO's attention on persons who accumulate significant interests. SROs could use this information to assess the ability of those persons to affect the operation of the SRO and its performance of its regulatory responsibilities. Providing detailed information regarding significant owners of the SRO or its facilities to the Commission, investors, members, and users of an SRO's facilities should help ensure greater accountability on the part of the exchange to monitor for undue influence or control of its regulatory and commercial operations, as well as further the ability of the Commission to carry out its oversight responsibilities over the SRO.

The Commission believes that requiring those exchanges and associations that are registered with the Commission as of the date of publication in the **Federal Register** of adoption of any proposed amendments to the forms to file a complete registration statement on revised Form 1 or new Form 2 within six months following such publication date would establish a baseline for all registered exchanges and associations and would facilitate bringing such exchanges and associations into the disclosure process as proposed to be revised. In addition, the Commission's proposal to require more frequent updates of amendments to revised Form 1 and new Form 2, and to post recent versions of the forms on a publicly accessible Internet Web site in lieu of paper filing, should benefit investors, market participants, and the Commission. The proposed amendments should enhance investor confidence in the integrity of the markets by requiring exchanges and associations to provide more regular and up-to-date disclosures about significant changes in their governance, regulation, administration, and significant ownership. The Commission expects that posting the most recent version of completed Form 1 or Form 2 on an Internet Web site would make such information more readily accessible to both the Commission and the public, thereby enhancing the transparency of each exchange and association. Web site disclosure should assist market participants and the public in their understanding and awareness of significant aspects of these SROs. Moreover, SRO members, market participants, investors and regulators would be able to more easily monitor the effectiveness and performance of SROs, thus helping to promote greater accountability by SROs with their Exchange Act obligations.

Finally, the Commission believes that the proposed elimination of Forms X–15AJ–1 and X–15AJ–2 and the proposed use of Form 2 as both the application for initial registration as a registered securities association or affiliated securities association, and the form for submitting amendments to the initial application, would provide for more uniform disclosure requirements for exchanges and associations than the existing regulatory scheme. The Commission believes that more closely aligning the disclosure requirements for exchanges and associations would benefit the Commission and the public, particularly in light of the fact that the Exchange Act imposes comparable requirements on these SROs. The Commission requests comment on the benefits of its proposals to increase disclosure on revised Form 1 and new Form 2.

2. Costs

The Commission anticipates that the additional disclosure requirements contained in the proposals, and the proposed requirements for more

[684] *See* Sections 6 and 15A of the Exchange Act, 15 U.S.C. 78f and 78*o*–3.

[685] *See* Sections 6(b) and 15A(b) of the Exchange Act, 15 U.S.C. 78f(b) and 78*o*–3(b).

frequent filing, would impose costs on exchanges and associations in terms of additional staff time dedicated to recordkeeping, the obtaining and compilation of data, annual preparation and internal review of revised Form 1 and new Form 2, respectively, and periodic amendments to the applicable form. However, much of the required information should be readily available to the boards of exchanges and associations and management of these SROs, particularly with respect to matters relating to governance structure. The Commission anticipates, however, that an exchange or association would incur greater costs in the first year or two after adoption of the proposals than in subsequent years. This is in part because the exchange or association would incur costs as it becomes familiar with the new requirements and sets up the mechanisms and internal procedures to collect and provide the information required by the forms' Exhibits, particularly the information relating to ownership of the exchange, association or a facility of either. Once these systems have been established, the Commission anticipates that the cost to maintain them would be relatively low. Under the proposed implementation schedule, the requirement that exchanges and associations that are registered with the Commission as of the publication date of adoption of any proposed amendments to the forms submit an initial complete revised Form 1 or new Form 2 from within six months following such publication date also would impose a higher initial cost on such exchanges and associations in the first year after the adoption of the proposals. A registered exchange or association, whose fiscal year ends after the final date by which such initial complete revised Form 1 or new Form 2, as applicable, must be submitted before the end of the calendar year in which such initial complete form is submitted, would incur higher costs in that first year because it also would be required to file an annual amendment in the same year as it submits the initial complete revised Form 1 or new Form 2, as applicable. The Commission believes that this is a necessary and justified cost, however, in order to bring currently registered exchanges and associations into the disclosure process, as proposed to be revised.

As discussed above in Section IX, Commission staff believes that exchanges and associations would incur some costs in gathering the documentation to comply with the proposed rule and form amendments. The Commission believes the initial paperwork burdens for an exchange or association filing an initial registration statement is estimated to be 157 hours per applicant. The yearly ongoing paperwork burdens for an exchange or association that has been approved for registration is estimated to be 48 hours per SRO.

The Commission also believes that those exchanges and associations that are registered with the Commission as of the publication date of adoption of any proposed amendments to the forms, and thus would need to file a complete registration on revised Form 1 or new Form 2 no later than six months following such publication date would incur a paperwork burden of 157 hours per exchange or association for the complete revised Form 1 or new Form 2, plus an additional 20 hours if an annual amendment is required within the same calendar year. The yearly ongoing paperwork burden for each such exchange or association would be 48 hours. As a result, these exchanges and associations could have to file a completed registration form twice within a twelve month period. An exchange or association also would incur costs in the mailing of paper filings and copies to the Commission. The Commission estimates that the costs of mailing an initial application on revised Form 1 or new Form 2 would be $673.33 per exchange or association.[686] The costs of filing a complete registration statement on revised Form 1 or new Form 2 no later than six months following the final rules' publication date is also estimated by the Commission to be $673.33 per exchange or association.[687] The Commission estimates that the costs of mailing an amendment to revised Form 1 or new Form 2 would be $365.86 per exchange or association.[688] We request comment on the costs associated with this implementation proposal.

As discussed in Section IX., for PRA purposes, the Commission estimates that total reporting and recordkeeping burden for an exchange that submits an initial registration or exemption application on the revised Form 1 would be 157 hours and $673.33 per applicant.[689] For exchanges that are already registered with the Commission, the estimated reporting and recordkeeping burden for filing a complete revised Form 1 and any requisite updating amendments for the first year in which the final rules' are published would be 177 hours and approximately $1,039 per exchange. Thus, the Commission estimates that the total recordkeeping and reporting burden for all nine registered exchanges for the first year in which the final rules' are published would be 1,593 hours and approximately $9,351. After the year in which an exchange initially files the revised Form 1, the Commission estimates that such exchange would bear an annual reporting and recordkeeping burden of 48 hours and $731.72, and that all exchanges would bear a total annual reporting and recordkeeping burden of 432 hours and approximately $6,585.

The Commission estimates that total reporting and recordkeeping burden for an association that submits an initial registration application on the new Form 2 would be 157 hours and $673.33 per applicant.[690] For associations that are already registered with the Commission, the estimated reporting and recordkeeping burden for filing a complete new Form 2 and any requisite updating amendments for the first year in which the final rules' are published would be 177 hours and approximately $1,039 per association. Thus, the Commission estimates that the total recordkeeping and reporting burden for the one registered association for the first year in which the final rules' are published would be 177 hours and approximately $1,039. After the year in which an association initially files the new Form 2, the Commission estimates that such association would bear an annual reporting and recordkeeping burden of 48 hours and $731.72.

Revised Form 1 and new Form 2 would require that exchanges and associations provide copies of certain documents to the Commission. For example, exchanges and associations would be required to provide a copy of the constitution and other governing documents, and a copy of all written rulings and interpretations.[691] Exchanges and associations also would be required to provide a copy of the written charter for each Standing

[686] The Commission estimates that an initial application and copies would weigh approximately 180 lbs, and would be mailed via courier/shipping service.

[687] *See supra* note 686.

[688] The Commission estimates that an amendment and copies would weigh approximately 60 lbs, and would be mailed via courier/shipping service.

[689] This total includes the burden of preparing and submitting the initial registration form, but does not include any initial start-up burden for creating a website (this is a burden on which the Commission is soliciting comments).

[690] This total includes the burden of preparing and submitting the initial registration form, but does not include any initial start-up burden for creating a website (this is a burden on which the Commission is soliciting comments).

[691] *See* proposed Exhibits A and B of revised Form 1 and new Form 2.

Committee.[692] In addition, exchanges and association would be required to submit a copy of the governance guidelines, code of conduct and ethics,[693] and copy of the procedures for interested persons to communicate concerns regarding matters within the jurisdiction or authority of a Standing Committee to independent directors.[694] Copies of delegation plans or other agreement relating to regulatory services provided to the exchange or association,[695] membership applications,[696] forms of financial statements, reports or questionnaires relating to financial responsibility or minimum capital requirements,[697] and listing applications[698] also would be required to be provided on revised Form 1 and new Form 2. The Commission believes that exchanges and associations already maintain these documents, and should only incur mailing costs, as discussed earlier.[699] The Commission, however, requests comment on whether exchanges and associations currently retain such documents.

However, other Exhibits to Forms 1 and 2 would require the exchange or association, respectively, to provide charts detailing aspects of its governance structure and internal organizational structure, as well as the relationship among the exchange, association, its facilities, and any affiliates.[700] If the exchange or association currently does not prepare such charts, it would incur costs in preparing these charts. The exchange or association also must provide a table indicating the compensation of the five most highly compensated executives.[701] The Commission does not expect that exchanges and associations would incur significant costs in preparing such charts or tables as this information is readily available to them. The Commission requests comment on the costs associated with the preparation of charts or tables in compliance with revised Form 1 and new Form 2.

Exchanges and associations also would be required to provide more detailed information regarding their regulatory programs, including revenues and expenditures related to those regulatory programs.[702] Exhibit H to revised Form 1 and new Form 2 would require exchanges and associations to provide a description of all of their regulatory programs. Further, Exhibit H would require a description of the structural independence of the regulatory program from market operation and other commercial interests of the exchange or association. Exchanges and associations would be required to discuss any significant changes that are planned for their regulatory programs. In addition, each exchange and association would be required to discuss fully any significant regulatory issues that have arisen or any significant events that have taken place in the past year, that relate to or otherwise may affect the exchange's or association's regulatory responsibilities or the operation of its regulatory program. Exhibit H also would require exchanges and associations to discuss the effect that these significant issues or events may have on the mission, strategy, and future operations of the exchange's or association's regulatory program.[703] An exchange or association would be likely to incur costs with regard to the description and discussion of the specified aspects of regulatory program that is necessary for compliance with proposed Exhibit H to revised Form 1 and new Form 2. The Commission requests comment on the costs of compliance with this proposal. The Commission further requests comment on whether the SRO would be likely to incur costs related to hiring and compensating outside counsel or consultants to aid in completing the description and discussion of specific aspects of the exchange's or association's regulatory program.

Revised Form 1 and new Form 2 would require exchanges and associations to submit audited financial statements. This requirement is contained in the current Form 1 and the Commission believes that there should not be significant new costs associated with providing audited financial statements. The Commission requests comment on the costs associated with the preparation and filing of audited financial statements in accordance with revised Form 1 and new Form 2.

Exchanges and associations would be required to disclose their regulatory expenses as a proportion of their total budget, and separately as a proportion of their total annual revenues. Pursuant to proposed Exhibit I to revised Form 1 and new Form 2, exchanges and associations would be required to disclose the aggregate amounts that they expend on regulatory activities, as well as the amounts that they expend on certain subcategories of regulatory activities, including supervisory activities, surveillance activities, and disciplinary activities. Revised Form 1 and new Form 2 also would require exchanges and associations to disclose the dollar amount of their revenues and expenses for each area (*e.g.*, surveillance, supervision, and discipline) of their regulatory programs, with detailed itemization within the following broad categories: revenues; direct expenses; and allocated expenses.[704] The Commission believes that the SROs currently track and maintain records of this financial information and that the costs of compliance with revised Form 1 and new Form 2 therefore would not be substantial. The Commission requests comment on the costs of compiling information about their regulatory revenues and expenses.

Exchanges and associations also would be required to provide an itemization of their non-regulatory expenditures, including, but not limited to, personnel expenses, program expenses, systems and other technology expenses, consultants and advisors, and overhead.[705] The Commission believes that the SROs currently track and maintain records of this financial information and that the costs of compliance with revised Form 1 and new Form 2 therefore would not be substantial. The Commission requests comment on the costs of compiling information about their non-regulatory expenditures.

Exchanges and associations also would be required to disclose all charitable contributions of the exchange or association (whether made directly or indirectly) in excess of $1,000 to a charity in which an executive officer or director of the applicant, or any of their immediate family members, is an executive officer or director of the

[692] *See* proposed Exhibit E of revised Form 1 and new Form 2.

[693] *See* proposed Exhibit F of revised Form 1 and new Form 2.

[694] *See* proposed Exhibit C of revised Form 1 and new Form 2.

[695] *See* proposed Exhibit H of revised Form 1 and new Form 2.

[696] *See* proposed Exhibit M of revised Form 1 and new Form 2.

[697] *See* proposed Exhibit N of revised Form 1 and new Form 2.

[698] *See* proposed Exhibit O of revised Form 1 and new Form 2.

[699] Moreover, as discussed below, the costs of filing some of the exhibits should be further reduced for exchanges and associations that choose to comply by posting specified Exhibits on an Internet Web site. *See* proposed Rules 6a–2(d) and 15Aa–2(d).

[700] *See* proposed Exhibits E, G, and P of revised Form 1 and new Form 2.

[701] *See* proposed Exhibit I of revised Form 1 and new Form 2.

[702] *See* proposed Exhibits H and I of revised Form 1 and new Form 2.

[703] *See* proposed Exhibit H to revised Form 1 and new Form 2.

[704] *See* proposed Exhibit I to revised Form 1 and new Form 2.

[705] *See* proposed Exhibit I to revised Form 1 and new Form 2.

charity.[706] Exchange and associations would incur costs in obtaining this financial information. The Commission requests comment on the costs of compiling information about charitable contributions of the exchange or association. The Commission further requests comment on whether SROs currently obtain information about charitable contributions from officers, directors, and their immediate family members. Commenters also are asked to comment on the ease by which an SRO could obtain information regarding charitable contributions required to be disclosed on revised Form 1 and new Form 2.

Further, under proposed Exhibit I, the exchange or association would have to incorporate a discussion of any unusual or infrequent events or transactions or any significant economic changes that have had a material effect on the financial condition of the exchange or association, and any known demands, commitments, events or uncertainties that would result in or are reasonably likely to result in a material change in financial condition. Proposed Exhibit I also would require a description of any significant business development involving the exchange or association, including a reorganization, merger or consolidation, acquisition or disposition of significant assets, or any other material change in business or operations.[707] An exchange or association is likely to incur costs with regard to the staff and board analysis and internal discussion of such events and changes that is necessary for compliance with proposed Exhibit I to revised Form 1 and new Form 2. The Commission requests comment on the costs of compliance with this proposal. The Commission further requests comment on whether the SRO would be likely to incur costs related to hiring and compensating outside counsel or consultants to aid in completing the requirements of proposed Exhibit I.

In addition, proposed Exhibit I would require exchanges and associations to describe all material contracts and all material related party transactions. Further, Exhibit I would require a description of the material commitments of the exchange or association for expenditures as of the end of the latest fiscal period, and indicate the general purpose of such commitments and the anticipated source of funds needed to fulfill such commitments.[708] SROs would incur costs to track and maintain records of this financial information. The Commission requests comment on the costs of compiling information about their material contracts and material related party transactions. The Commission further requests comment on whether SROs currently maintain records of their material contracts and related party transactions, and, if not, the ease of with which an SRO could obtain such information.

Finally, proposed Exhibit I would require a description of the material terms of the employment agreements of the five most highly compensated executives of the exchange or association and would require the exchange or association to provide a description of the compensation provided to members of its board.[709] The Commission believes that the SROs currently track and maintain records of their compensation agreements with executives and that the costs of compliance would therefore not be substantial. The Commission requests comment on the costs of compiling information about employment agreements with the five most highly compensated executives of the exchange or association.

Overall, the Commission requests comment as to the types of records exchanges and associations presently maintain with respect to their budgets, revenues, and expenses, and, in particular, the revenues and expenses associated with their regulatory programs. Further, the Commission recognizes that exchanges and associations, would incur costs in the first year or two in setting up the format for disclosing revenues and expenditures according to the categories set forth in proposed Exhibit I to Forms 1 and 2, and in becoming familiar with the format. The Commission seeks comment on the costs that would be incurred by an exchange or association in preparing the proposed financial data contained in proposed Exhibit I according to the categories set forth therein.

Proposed Exhibit Q to revised Form 1 and new Form 2 would require the exchange or association to disclose detailed information regarding direct and indirect significant (more than 5%) owners of the exchange or association or a facility thereof. Although an exchange or association may already collect or have access to some of this information, it is likely that it would incur costs associated with putting in place a process to obtain more detailed information, both in terms of the type of ownership information (*e.g.*, number of shares, contracts relating to ownership) and the scope of persons whose ownership interest must be aggregated together (*e.g.*, a person's interest must be aggregated with any of its ''related persons'' ''its affiliates, associated persons, and immediate family members). Facilities of the exchange or association also may incur costs associated with obtaining and providing ownership information to the exchange or association. The Commission believes that these costs would likely be more in the first year or two as the exchange, association or facility becomes familiar with the process, but recognizes that there would be ongoing costs to continually obtain this information. The Commission requests comment on the accuracy of this view and on the specific costs of obtaining and providing such detailed ownership information pursuant to revised Form 1 and new Form 2. The Commission further requests comment on the ease or difficulty an SRO would encounter to obtain all the information required to be disclosed by proposed Exhibit Q, including information regarding related persons. In addition, commenters are requested to provide information on costs associated with monitoring ownership on an on-going basis, including whether exchanges and associations would have to file a proposed rule change with the Commission to make changes to their rules to allow them to request this information from their or a facility's owners.

The Commission proposes to more closely align the disclosure requirements for exchanges and associations. Currently, associations are not required to provide the same kind of information as exchanges. As a result of the proposed revisions that would require associations to disclose information in a format that is comparable to the one currently used by exchanges, associations likely would incur greater costs to comply with the disclosure requirements of new Form 2 than exchanges would face in complying with revised Form 1. The Commission requests comment on the costs of requiring more uniform registration forms for exchanges and associations.

With limited exceptions,[710] revised Form 1 or new Form 2, and all subsequent amendments thereto, would be required to be filed in paper format with the Commission, as well as posted on a publicly accessible Internet Web site controlled by the exchange or association. The exchanges registered

[706] *See id.*

[707] *See id.*

[708] *See id.*

[709] *See id.*

[710] *See* proposed Rules 6a–2(d) and 15Aa–2(d).

under Section 6(a) of the Exchange Act and the only association registered under Section 15A(a) of the Exchange Act, the NASD, all currently maintain publicly accessible Internet Web sites.[711] Therefore, each exchange and association should incur minimal costs in updating their Internet Web sites to meet the proposed requirements. The Commission seeks comment on these costs.

The Commission recognizes that certain exhibits require information that changes frequently; in addition, the paper involved to prepare those Exhibits could be voluminous. For that reason, the proposed rules provide that with respect to Exhibits A, B, M, N, S, or T, or Items 1–7 of Exhibit L,[712] of revised Form 1 and new Form 2, an exchange or association, in lieu of filing such information on paper, would be required only to identify the Internet Web site it controls where such information is available continuously and to certify to the accuracy of such information as of the date of filing. The Commission, in the future, may consider the feasibility of eliminating the paper filing requirement and permitting the forms and exhibits to be posted on an Internet Web site controlled by the SRO, filed electronically with the Commission or through some other means. The Commission seeks comment on these costs.

3. Request for Comment

The Commission requests data to quantify the costs and benefits associated with its proposals to improve SRO transparency and provide for uniform regulatory treatment of exchanges and associations. The Commission seeks estimates of these costs and benefits, as well as any costs and benefits not already defined, which may result from the adoption of these proposed amendments to Rule 6a–2, new Rule 15Aa–1, revised Form 1, and new Form 2, along with the proposed repeal of Forms X–15AJ–1 and X–15AJ–2. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

D. Costs and Benefits of Proposed Amendments to Rule 17a–1

The proposed change to Rule 17a–1 would require national securities exchanges, national securities associations, registered clearing agencies and the Municipal Securities Rulemaking Board to keep in the United States at least one copy of all documents required to be kept by Section 17(a)[713] of the Exchange Act and Rule 17a–1 thereunder.[714]

1. Benefits

While the Commission believes that in practice SROs subject to Rule 17a–2 currently keep copies of all documents in the United States, the Commission is concerned that, given the globalization of the securities markets and the trend of SROs to demutualize, there is a greater potential that an SRO may be owned by a non-U.S. entity. By proposing to require that at least one copy of each document is kept in the United States, such documents should be more readily accessible for inspection and examination by the Commission pursuant to Section 17 of the Exchange Act,[715] thus increasing the efficiency and effectiveness of Commission examinations and aiding the Commission's ability carry out its oversight responsibilities. The Commission seeks comment on any additional benefits of the proposed changes to Rule 17a–1.

2. Costs

The Commission preliminarily believes that the proposed changes to Rule 17a–1 would impose minimal costs, if any, on national securities exchanges, national securities associations, registered clearing agencies and the Municipal Securities Rulemaking Board. The Commission believes that the proposed changes to Rule 17a–1 would reflect the current practice of these entities to keep at least one copy of their documents in the United States. To the extent one of these entities currently keeps its documents outside the United States, the Commission preliminarily believes that any storage and staff costs incurred in keeping the documents in the United States would be at least partially off-set by the reduction in storage and staff costs of keeping the documents outside of the United States. The Commission recognizes, however, that such SRO may incur costs to maintain duplicate sets of books and records.

3. Request for Comment

The Commission seeks comment on whether there are any additional costs of the proposed change to Rule 17a–1, including specifics of the dollar amount of such cost impact, and whether any national securities exchanges, national securities associations, registered clearing agencies or the Municipal Securities Rulemaking Board currently keeps documents solely outside of the United States. The Commission also requests comment on any additional benefits associated with the proposed change to Rule 17a–1.

E. Costs and Benefits of Proposed Rule 17a–26

The Commission proposes to adopt new Rule 17a–26 under the Exchange Act, which would require every national securities exchange and registered securities association, other than a national securities exchange registered pursuant to Section 6(g) of the Exchange Act[716] and a limited purpose national securities association registered pursuant to Section 15A(k)(l) of the Exchange Act,[717] to file with the Commission, on a quarterly and annual basis, reports that contain the information specified by the rule. The reports would be submitted electronically. Proposed Rule 17a–26 would require exchanges and associations to establish procedures for the preparation of the required reports in a uniform, readily accessible, and usable electronic format.

The quarterly reports would include information with respect to an exchange's or association's surveillance program; complaints received; investigations, examinations, and enforcement cases; and listings information; as well as copies of final agenda from any board or board committee meeting that took place during the quarter.[718] The annual report would contain: (1) An aggregated year-end cumulative summary of specified categories of information regarding the SRO's regulatory program in the quarterly reports; (2) additional updated information on all items that are required to be part of the annual report, including a discussion of regulatory program procedures, the effectiveness of the regulatory program, internal controls addressing conflicts of interest, employment arrangements with senior regulatory personnel, efforts to comply

[711] *See supra* note 546 and accompanying text.

[712] These proposed Exhibits to revised Form 1 and new Form 2 would require disclosure of: governance documents and rules (Exhibit A); written rulings and interpretations (Exhibit B); membership forms (Exhibit M); documents relating of financial responsibility or minimum capital requirements (Exhibit N); list of members and other users (Exhibit S); securities listed and traded (Exhibit T); and certain information regarding the manner of operation of an SRO trading facility (Items 1–7 of Exhibit L).

[713] 15 U.S.C. 78q(a).

[714] 17 CFR 240.17a–1. *See supra* Section IV.C.11 for a discussion of the proposed change to Rule 17a–1.

[715] 15 U.S.C. 78q.

[716] 15 U.S.C. 78f(g).

[717] 15 U.S.C. 78*o*–3(k)(l).

[718] *See* proposed Rule 17a–26(b)(2).

with undertakings made to the Commission, and copies of the proposed Standing Committee self-evaluations and the annual governance performance evaluation prepared by the Governance Committee; and (3) an independent audit of any electronic SRO trading facility.[719] Finally, exchanges and associations would be required to file a supplement under certain circumstances in order to provide information concerning material changes or material events that affect the SRO's regulatory program.[720]

1. Benefits

Proposed new Rule 17a–26 is intended to enhance the Commission's ability to monitor national securities exchanges' and registered securities associations' compliance with their self-regulatory responsibilities, particularly during the period between inspections by the Commission. The reports filed by these SROs would enable the Commission to monitor, on a routine basis, key aspects of the exchanges' and associations' regulatory programs; assess the SROs' responses to critical issues affecting them; and better target the Commission's inspection resources. Moreover, analysis of information provided in the reports should aid the Commission and SROs in the regulation and evaluation of other regulated entities, such as brokers and dealers. By utilizing the information in the reports, the Commission and SROs would better be able to target their resources to adopt rules to deter violative behavior, or to remove regulation that may be unnecessary.

The Commission also would be able to use the reports to identify compliance trends within and among the exchanges and associations, including trends in exception reports and enforcement activities. The quarterly and annual reports would allow the Commission to monitor for developments, both within a given exchange or association and among the various exchanges and associations, upon which the Commission may be required to act. Thus, proposed Rule 17a–26 would assist the Commission in its efforts to stay abreast of new developments and challenges affecting exchanges and associations, their regulatory programs, their members and investors, and would permit the Commission and its staff to better identify, on a more contemporaneous basis, issues that warrant further investigation or immediate attention. The proposed rule also would assist the Commission by allowing it to utilize its inspection staff and resources more effectively.

The Commission also believes that proposed Rule 17a–26 would provide benefits to exchanges and associations. The proposed rule should have a positive effect on exchange and association compliance practices. For example, the requirement that exchanges and associations obtain an annual audit of the operations of any of their electronic SRO trading facilities would help assure that such facilities are operated in compliance with all applicable legal and regulatory requirements. Given the technological and operational complexity of many electronic SRO trading facilities, the annual audit could help to ensure the integrity of these systems in practice with respect to their proper functioning and regulatory compliance. The Commission would be able to use such information in monitoring SRO compliance with Exchange Act rules and regulations, and SROs could be encouraged to take action on their own initiative to address any regulatory concerns raised by such audit.

In addition, the proposed rule would require exchanges and associations to review, on at least a quarterly basis, the operation and performance of their regulatory programs. In summarizing material and preparing the reports required under the proposed rule, exchanges and associations would benefit by the opportunity to review on a quarterly basis the strengths and weaknesses of their regulatory programs. Exchanges and associations could use the reports to track surveillance and enforcement trends within their regulatory programs, as well as monitor trends in complaints received regarding the operation of their regulatory programs. The Commission expects that the reporting requirements should help exchanges and associations identify potential weaknesses in their compliance practices and surveillance programs, allowing them to update and strengthen their regulatory programs as needed.

The Commission also expects that proposed Rule 17a–26 would encourage exchanges and associations to stress the importance of an active, top-quality compliance program, including thorough and diligent surveillance and enforcement, to their members and to their listed issuers, as well as to the senior management of the exchange or association. The annual and quarterly reports also would be a useful tool to allow the board of the exchange or association, as well as management, to monitor the operation of the exchange's or association's regulatory program over time. Finally, knowledge that SROs are submitting reports on a periodic basis to the Commission on their regulatory programs should contribute to an increased confidence by investors, issuers, and other market participants in the market as a whole.

2. Costs

Proposed Rule 17a–26 would require national securities exchanges and registered securities associations to file quarterly and annual reports with the Commission. As discussed above in Section IX., the Commission believes that exchanges and associations would incur costs to comply with the proposed rule. In particular, based on information available to the Commission at this time, the Commission estimates that each national securities exchange and registered securities association would incur an average burden of 40 hours to prepare each quarterly report and 35 hours to prepare each annual report required by the proposed rule, for an annual burden of 195 hours per respondent. Accounting for nine national securities exchanges and one registered securities association, the total burden to comply with the quarterly and annual reporting requirements in proposed new Rule 17a–26 is therefore estimated to be 1,950 hours per year. Further, for purposes of this release, the Commission estimates that an exchange or association would incur a burden of 4 hours to prepare each interim updating amendment, which would likely be required, on average, 5 times per year for a total of 20 hours per respondent and 200 hours total for the nine exchanges and one association. Accordingly, as discussed above in Section IX., the total burden resulting from the proposed rule's quarterly and annual reporting provisions would be 2,150 hours and $60[721] to prepare and file with the Commission each report and interim supplement.

The Commission notes that some exchanges and associations could need to hire additional staff to comply with the requirements of the proposed rule. Whether an exchange or association

[719] *See* proposed Rule 17a–26(a)(2) and (b)(3). The term ''electronic SRO trading facility'' would be defined as a facility of an exchange or association that executes orders in securities on an electronic basis. *See* proposed Rule 17a–26 (j)(3).

[720] *See* proposed Rule 17a–26(d)(1).

[721] The Commission estimates that an average filing will weigh two ounces, accounting for a diskette and accompanying letter, and will be mailed via first class mail at a rate of $0.37 for the first ounce and $0.23 for the additional ounce, for a total of $0.60 per filing. At four quarterly reports, one annual report, and an estimated five interim supplements, the Commission expects that each exchange or association would incur a cost of $6 to comply with the proposed rule. The Commission solicits comments on the accuracy of this estimate.

would need to hire additional staff to gather information and prepare the required reports would depend on the thoroughness and effectiveness of an exchange's or association's current recordkeeping systems and practices, the level and extent of regulatory activity subject to quarterly reporting (*e.g.,* an exchange that experiences unusually heavy enforcement activity or has highly active listings activity could incur a greater reporting burden), and the current workloads of existing staff. The Commission expects that most exchanges and associations, in fulfilling their self-regulatory and recordkeeping requirements, are currently collecting most, if not all, of the information required to be reported under the proposed rule. Based on conversations with two of the larger SROs, the Commission understands that much of the information required by the proposed rule, in particular with respect to the quarterly reports, currently is maintained by those SROs. Specifically, the information that would be required to appear in the quarterly reports, including the results of surveillance programs; information on complaints received; information on investigations and examinations; information on enforcement cases; information on new listings, delistings, and alleged failures to satisfy listing standards; and board and board committee agenda, generally is retained by those SROs in varying formats. Accordingly, the primary cost to those SROs with respect to the information they currently retain would be in assembling that information into an electronic report for submission to the Commission. Thus, a primary burden on an exchange or association would be to prepare a consolidated electronic report containing all of the information proposed to be required, to the extent that it is not doing so already as part of its routine business practices. The Commission seeks comment on these costs. The Commission also requests comment on the extent to which exchanges and associations currently maintain this information in electronic format.

The required annual reports would require exchanges and associations to aggregate information contained in the quarterly reports to be submitted as part of the annual report; however, the Commission expects that those costs would not be substantial. Given the proposed electronic nature of the quarterly reports, the Commission would expect that it would not be a costly or complicated task for an SRO to aggregate the quarterly information and incorporate the data into the proposed annual report. The Commission requests comment on the costs of compiling the data and preparing the proposed annual report. Exchanges and associations should comment on whether such reports would be prepared in-house or by outside counsel or advisors. Comment is also requested on whether exchanges and associations would expect to purchase software or hardware to aid in the preparation of the proposed annual reports.

The Commission believes that exchanges and associations would incur costs related to the proposed requirement to include in the annual report an audit of any electronic SRO trading facility, which must be prepared by an independent third party. The purpose of this audit is to assess whether the operations of the electronic SRO trading facility comply with the rules governing the facility. Because the exchange or association would need to hire an independent third party to conduct this annual audit, it would incur ongoing yearly costs to comply with this requirement. As discussed above in Section IX., the Commission estimates that nine national securities exchanges and one registered securities association would be required to obtain and submit as part of the annual report, an annual audit of any electronic SRO trading facility, and each such exchange or association owning, operating, or sponsoring at least one such facility would spend approximately 15 hours interacting with the third party with respect to their conduct of the audit and preparation of the audit report and 20 hours reviewing each audit report received from the third party, for a total of 35 hours per exchange or association per year, for a total annual reporting and recordkeeping burden of 350 hours. With respect to the third-party auditor, the Commission estimates that it would take each third party 100 hours to conduct the audit and prepare the audit report for each exchange or association that owns, operates, or sponsors at least one electronic SRO trading facility, for a total annual cost per exchange or association of $15,000,[722] resulting in a total annual burden cost of $150,000. The Commission requests comment on the expected costs of hiring an independent third-party to conduct the proposed annual audit. Exchanges and associations should comment as to whether they currently use the services of an independent third party to audit their operations and what type of business the third party is primarily engaged in (*e.g.,* legal, consultant, financial). The Commission notes, however, that certain other annual report requirements, such as the discussion of internal controls and the discussion of the processes for carrying out regulatory responsibilities, should not impose significant costs on exchanges and associations.

Further, the Commission believes that exchanges and associations would incur initial start-up costs as part of the proposed rule. Exchanges and associations would be required to establish procedures for a uniform, readily accessible, electronic format for the required data. While these SROs would incur start-up costs in establishing these procedures, the Commission does not believe that these start-up costs would be significant. As stated above in Section IX., the Commission estimates that each exchange or association would spend approximately 35 hours during the initial year of the proposed rule's effectiveness to establish procedures for the preparation of the reports required by the proposed rule in a uniform, readily accessible, and usable electronic format. Accounting for nine national securities exchanges and one registered securities association, the total burden per year to comply with the provision in proposed Rule 17a–26 regarding the uniform format for the quarterly and annual reports is estimated to be 350 hours. The Commission seeks comment on these costs.

3. Request for Comment

The Commission requests data to quantify the costs and benefits of proposed Rule 17a–26. The Commission seeks estimates of these costs and benefits, as well as any costs and benefits not discussed above, that may result from the adoption of this proposed rule. Commenters are requested to provide empirical data and other factual support for their views to the extent possible. The Commission specifically requests comment on the costs and benefits associated with the Commission's proposal to require periodic regulatory reports from exchanges and associations, including both start-up costs and annual ongoing compliance costs. The Commission also specifically requests comment on the costs and benefits of obtaining the report of an independent third party relating to the annual review of the

[722] The estimate assumes that the report will be prepared by an independent accounting firm or similar entity for the exchange or association at an estimated cost of $150 per hour, based on an hourly estimate for auditing services obtained from industry sources. The Commission requests comment on this estimate, and on what type of entity an exchange or association may hire to prepare this report.

operations of an electronic SRO trading facility.

F. Costs and Benefits of Proposed Rule 17a–27

Proposed Rule 17a–27 would require any member of an exchange or association that is a broker or dealer to provide a report to the Commission and the exchange or association of which it is a member when it, alone or together with its related persons, acquires, directly or indirectly, more than 5% of any class of securities or other ownership interest of such exchange, association, or of a facility of such exchange or association through which it is permitted to effect transactions.[723]

1. Benefits

As discussed above, a member of an exchange or association that is a broker or dealer and that owns a significant interest in such exchange, association, or a facility thereof potentially could control or influence the regulatory process and market operations of the exchange or association to its benefit. Requiring such members to furnish a statement to the Commission, and a copy of the statement to the SRO, describing their ownership interests in an exchange, association or facility, along with information regarding the member's ability to influence the management of the exchange or association, would help guard against any potential abuses of influence or control of the SRO's regulatory authority by alerting the Commission and the applicable exchange or association to accumulations of significant ownership interests by its members that are brokers or dealers. Providing information to the Commission on accumulations of interest by these members would facilitate the SRO's ability to effectively perform its regulatory obligations, and the Commission's ability to effectively carry out its statutory oversight responsibilities with respect to the exchange or association, by allowing the Commission and the applicable exchange or association to more easily monitor for accumulations of significant interests, to monitor the effects of such ownership, and to monitor the ability of a person or group of related persons to influence the operation of the exchange, association, or facility.

Moreover, providing copies of the statement to the applicable exchange or association for which ownership information is provided would facilitate the exchange's or association's ability to monitor whether the ownership interests of its members that are brokers or dealers are in compliance with the proposed limits on broker-dealer members' ownership in and voting of interests in the SRO or its facilities. In addition, proposed Rule 17a–27 would assist exchanges and associations in complying with the proposed requirement of Exhibit Q to revised Form 1 and new Form 2 that would require exchanges and associations to provide disclosure to the Commission regarding any person that owns more than 5% of the exchange, association, or a facility thereof.

2. Costs

The Commission recognizes that the proposed rule would impose costs on members that are brokers or dealers to track, calculate, and report ownership of more than 5% in an exchange or association of which it is a member or of a facility of an exchange or association through which it is permitted to effect transactions. The Commission preliminarily believes that, given the nature of their business, most members that are brokers or dealers currently have in place systems to track their ownership (and that of their affiliates) of securities, even for securities for which there is no reporting requirement under Sections 13(d) or 13(g) of the Exchange Act, but specifically requests comment on this issue.[724] The proposed rule likely would, however, require these members to make modifications to their systems and procedures to obtain additional ownership information for ''related persons'' for which they might not already obtain such information. For instance, the definition of ''related person'' includes immediate family members of the member (if such member is a natural person) and of a person associated with a member.[725] The Commission notes that if the exchange, association, or facility is a public reporting company under Section 12 of the Exchange Act,[726] members of the exchange or facility are required under Regulation 13D under the Exchange Act[727] to monitor their ownership interests in such entity and to file a Schedule 13D or 13G if they exceed the 5% reporting threshold.[728] However, because the scope of the reporting requirement of proposed Rule 17a–27 is broader than what is required by Schedule 13D and 13G, members may incur additional costs to comply with the proposed rule. In addition, for exchanges, associations or facilities that are not public reporting companies under Section 12 of the Exchange Act,[729] the member likely would incur greater costs to comply with proposed Rule 17a–27 because such members currently are not required to monitor their ownership interests in those entities. The Commission requests comment on the costs associated with obtaining and calculating ownership information under the proposed rule.

A member of an exchange or association that is a broker or dealer and that exceeds the reporting threshold also would incur costs to prepare and file the statement required by proposed Rule 17a–27. Such members would incur in-house legal, compliance and administrative costs associated with preparing and filing the initial report and periodic amendments in the event of an increase or decrease of more than 1% of the ownership interest last reported. The members also may incur outside legal costs associated with preparing these reports; although the Commission preliminarily believes that preparation of the report likely would not be outsourced, the Commission requests comment on this issue. As discussed above in Section IX., the Commission estimates that a member would spend approximately 35 hours to prepare and file the initial report, 2 hours and $1.29 to prepare and send a copy of the report or any amendment to the exchange or association and 10 hours to prepare and file any amendment, resulting in a total initial annual burden for all members of 4,700 hours and $258, and 1,200 hours and $258 annually thereafter. Additionally, the Commission estimates that each exchange or association would spend 4 hours to post a member's report on its Web site, resulting in a total annual burden of 400 hours for all exchanges and associations.

3. Request for Comment

The Commission requests comment on whether there are any additional costs of the proposed Rule 17a–27. The Commission also requests comment on quantifying the amount of time and the dollar amount of the costs discussed above and any additional costs, including the costs associated with

[723] *See* supra Section VI. for a discussion of the proposed rule.

[724] For example, members may monitor their ownership interests to prevent and monitor conflicts of interests and for supervision and compliance purposes.

[725] The Commission preliminarily believes that most, if not all, members require their associated persons to report their securities transactions and holdings to the member. *See, e.g.,* NASD Rule 3050. Thus, the member could incorporate this information into its system for tracking ownership as would be required by proposed Rule 17a–27.

[726] 15 U.S.C. 78*l*.

[727] 17 CFR 240.13d–1 through 13d–7.

[728] 17 CFR 240.13d–101 or 240.13d–102.

[729] 15 U.S.C. 78*l*.

tracking and reporting ownership interests pursuant to the proposed rule. The Commission also seeks comment on any additional benefits of the proposed Rule 17a–27.

XI. Consideration of Burden on Competition, and Promotion of Efficiency, Competition, and Capital Formation

Section 3(f) of the Exchange Act requires the Commission, whenever it engages in rulemaking or in the review of a rule of an SRO, and it is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[730] Section 23(a)(2) of the Exchange Act [731] requires the Commission, in adopting rules under the Exchange Act, to consider the impact that any such rules would have on competition. Section 23(a)(2) also prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.[732]

The Commission has considered the proposed rules in light of these standards and preliminarily believes that they will not impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. In addition, the Commission believes that the proposed governance rules should have a beneficial impact on efficiency, competition, and capital formation. In particular, proposed Exchange Act Rules 6a–5 and 15Aa–3 are designed to strengthen the independence of SROs' governance and regulatory processes by enhancing the independence and effectiveness of exchange and association boards and those board committees. Moreover, the independence of exchanges' and associations' regulatory programs should be strengthened by the proposal to require the separation of their regulatory programs from their market operations and other commercial interests, as well as by the prohibition on using regulatory funds for non-regulatory purposes and the prohibition on using regulatory information for competitive purposes. Further, the proposed limitations on ownership and voting should help prevent members of an exchange or association that are brokers or dealers from being able to influence the operation of the exchange or association and the performance of its regulatory function in a manner detrimental to its competitors or in a manner favorable to such person or its affiliates. Overall, these requirements would help prevent an exchange or association from disregarding the regulatory process, and should help bolster investors' confidence in the entities that oversee and operate our nation's securities markets. Similarly, the Commission believes that the disclosure requirements under proposed Exchange Act Rules 6a–2, 15Aa–1, 15Aa–2 and the related Forms 1 and 2 are appropriately tailored to provide the Commission and the public with important information about an exchange's or association's governance practices and regulatory programs. To the extent that the proposed rules would affect efficiency, competition, and capital formation, we believe that any effect would be positive because these proposals should help improve the transparency of exchanges and associations and thus increase investor confidence in the administration and operation of the securities markets.

The Commission believes that the reporting requirements of proposed new Exchange Act Rule 17a–26 would not impose any unnecessary or inappropriate burden on competition because they would enhance the Commission's ability to monitor exchanges' and associations' compliance with their regulatory responsibilities, particularly during the period between inspections by Commission staff. Further, proposed Rule 17a–26 should enable the Commission to deploy its inspection resources more efficiently and to monitor more effectively these SROs' responses to critical issues affecting their markets. In addition, the Commission believes that, to the extent that there is any impact on efficiency, competition, and capital formation as a result of proposed Rule 17a–26, the result would be a positive one. The proposal is designed to require exchanges and associations to provide quarterly and annual information about key features of their regulatory programs, which in turn should heighten these SROs' attention to their regulatory responsibilities under the Exchange Act as they prepare the required quarterly and annual reports.

The proposed amendments to Rule 17a–1 and proposed new Rule 17a–27 should bolster investor confidence in the markets by helping to ensure that the Commission is able to carry out its oversight responsibilities over national securities exchanges and registered securities associations. In addition, proposed Regulation AL, by requiring notice and heightened reporting by an exchange or association to the Commission with respect to the exchange's or association's oversight of the listing and trading of the securities of an affiliated issuer, should help bolster investor confidence that the exchange or association is fairly and effectively carrying out its regulatory obligations with respect to the listing and trading of the affiliated security.

By promoting investor confidence in the fairness and integrity of our markets, and in the entities that oversee and operate our securities markets, investors may be more willing to effect transactions in those markets, which in turn would help to increase liquidity and to foster the capital formation process. The Commission requests comment on whether the proposed rules are expected to affect efficiency, competition, and capital formation.

XII. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or ''SBREFA,'' [733] the Commission must advise the Office of Management and Budget as to whether proposed Exchange Act Rules 3b–19, 6a–5, 15Aa–3, 17a–26, 17a–27, or Regulation AL; the proposed amendments to Form 1 under the Exchange Act, redesignated Form 2 under the Exchange Act, Exchange Act Rules 6a–2, 15Aa–1 and 17a–1, or redesignated Exchange Act Rule 15Aa–2; or the removal of Forms X–15AJ–1 and X–15AJ–2 under the Exchange Act constitute a ''major'' rule. Under SBREFA, a rule is considered ''major'' where, if adopted, it results or is likely to result in:

- An annual effect on the economy of $100 million or more (either in the form of an increase or a decrease);
- A major increase in costs or prices for consumers or individual industries; or
- A significant adverse effect on competition, investment, or innovation.

If a rule is ''major,'' its effectiveness will generally be delayed for 60 days pending Congressional review. We request comment on the potential impact of the proposed Exchange Act rules on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

[730] 15 U.S.C. 78c(f).

[731] 15 U.S.C. 78w(a).

[732] 15 U.S.C. 78w(a)(2).

[733] Pub. L. 104–121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C., and as a note to 5 U.S.C. 601).

XIII. Regulatory Flexibility Act Certification

Section 3(a) of the Regulatory Flexibility Act (''RFA'')[734] requires the Commission to undertake an Initial Regulatory Flexibility Analysis (''IRFA'') of the proposed rules and amendments on small entities unless the Commission certifies that the proposed rules and amendments, if adopted, would not have a significant economic impact on a substantial number of small entities.[735] The Commission hereby certifies, pursuant to 5 U.S.C. 605(b), that the proposed Rules 3b–19, 6a–5, 15Aa–2, 15Aa–3, 17a–26, and 17a–27, proposed Regulation AL, revised Rules 6a–2, 15Aa–1, 17a–1, and revised Form 1 and new Form 2, if adopted, would not have a significant economic impact on a substantial number of small entities. Proposed Rules 3b–19, 6a–5, 15Aa–2, 15Aa–3, and 17a–26, proposed Regulation AL, Section (d) of proposed Rule 17a–27, revised Rules 6a–2, 15Aa–1, 17a–1, and revised Form 1 and new Form 2 would apply only to national securities exchanges, exchanges exempted from such registration based on limited volume, registered securities associations, or affiliated securities associations. Neither national securities exchanges, exchanges exempted from such registration based on limited volume, registered securities associations, nor affiliated securities associations, are considered ''small entities'' within the meaning of the Regulatory Flexibility Act.[736] Accordingly, the Commission does not believe that proposed Rules 6a–5, 15Aa–2, 15Aa–3, and 17a–26, proposed Regulation AL, revised Rules 6a–2, 15Aa–1, 17a–1, and revised Form 1 and new Form 2 would have a significant economic impact on a substantial number of small entities.

Proposed Rules 17a–27(b) and (c) would apply to any member of an exchange or association that is a broker or dealer. The Commission preliminarily believes that proposed Rules 17a–27(b) and (c) would not have a significant economic impact on a substantial number of small entities. Proposed Rules 17a–27(b) and (c) would apply to any member of a national securities exchange or registered securities association that is a broker or dealer and that, alone or together with its ''related persons,''[737] directly or indirectly beneficially owns more than 5% of any class of securities or other ownership interest of such exchange or association, or a facility of an exchange or association. The Commission estimates there are approximately 6,800 members of an exchange or association that are registered brokers or dealers,[738] of which approximately 906 are considered small entities.[739] Although the Commission does not have sufficient data to determine how many members that are brokers or dealers and are small entities have or would have, alone or together with their related persons, ownership interests that would trigger the requirements of proposed Rule 17a–27, the Commission believes it is unlikely that any member that is a broker or dealer and is a small entity would trigger the 5% threshold, given the $500,000 capital limit a broker or dealer must not exceed to be considered a small entity.[740] Based upon information available to the Commission at this time, the Commission estimates that there are less than 20 brokers or dealers that would trigger the requirements of proposed Rules 17a–27(b) and (c), and that these brokers or dealers would not be considered small entities. The Commission requests comment on this estimate. Furthermore, because of the cost of acquiring 5% or more of the securities of or other ownership interest in an exchange, association or facility thereof, the Commission believes it is unlikely that any broker or dealer that is a small entity would acquire such a substantial interest.[741] Even if such a broker or dealer did acquire an interest in excess of 5%,[742] the Commission does not believe that a substantial number would do so, given the limited number of exchanges, associations and facilities, and the relatively high price of acquiring such an interest. Consequently, the Commission does not believe that a substantial number of small entities would be required to prepare and file reports with the Commission pursuant to proposed Rule 17a–27. In addition, if a small broker or dealer did have to file a report with the Commission because it exceeded the 5% threshold, the Commission does not believe that the preparation and filing of that report would have a significant economic impact on the broker or dealer.[743]

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[734] 5 U.S.C. 603(a).

[735] 5 U.S.C. 605(b).

[736] 5 U.S.C. 603.

[737] Pursuant to proposed Rule 17a–27(a)(13), the term ''related person'' would be defined to mean, with respect to any member that is a broker or dealer: (i) Any affiliate of the member; (ii) any person associated with the member; (iii) any immediate family member of such member, or any immediate family member of the member's spouse, who, in each case, has the same home as the member or who is a director or officer of the disclosure entity or any of its parents or subsidiaries; and (iv) any immediate family member of the person associated with the member, or any immediate family member of that person's spouse, who, in each case, has the same home as the person associated with the member or who is a director or officer of the disclosure entity or any of its parents or subsidiaries. Pursuant to proposed Rule 17a–27(a)(6), the term ''disclosure entity'' would be defined to mean, with respect to any member: (i) A national securities exchange of which it is a member, other than an exchange registered pursuant to Section 6(g) of the Exchange Act; (ii) a registered securities association of which it is a member, other than a limited purpose national securities association registered pursuant to Section 15A(K)(l) of the Exchange Act; and (iii) a facility of such national securities exchange or registered securities association through which it is permitted to effect transactions.

[738] *See id.*

[739] Based on the data in reports filed pursuant to Exchange Act Rule 17a–5, the Commission has determined that 906 of the 6,553 filers are ''small entities.'' Paragraph (c) of Rule 0–10 of the Act states that the term ''small business,'' when referring to a broker or dealer, means a broker or dealer that: (i) Had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to 17 CFR 240.17a–5(d) or, if not required to file such statements, a broker or dealer that had total capital (net worth plus subordinated liabilities) of less than $500,000 on the last business day of the preceding fiscal year (or in the time that it has been in business, if shorter); and (ii) is not affiliated with any person (other than a natural person) that is not a small business or small organization as defined in Rule 0–10.

[740] 17 CFR 240.0–10(c)(1). *See supra* note 739.

[741] For example, there were 46,310,865 outstanding shares of common stock of Archipelago Holdings, Inc. as of August 12, 2004 (*see* Archipelago Holdings, Inc.'s prospectus dated August 12, 2004, filed with the Commission on August 12, 2004). Based on the closing price of $17.46 per share for Archipelago Holdings, Inc.'s common stock on November 3, 2004, 5% of the common stock of Archipelago Holdings, Inc. would be valued at approximately $43,886,461 (assuming the number of outstanding shares has not increased or decreased). There are 1,366 ''seats'' on the NYSE. These seats represent an ownership interest in the NYSE. Based on the last reported sale price of a NYSE seat on October 29, 2004 of $1,035,000 (*see* NYSE's Web site, *www.nyse.com*), a 5% ownership interest in the NYSE would be valued at approximately $70,690,500. Similarly, there are over 200 seats on the BSE. Assuming 200 seats and based on the last reported sale price of $5,000 on April 6, 2004 (*see* BSE's Web site, ''*www.bostonstock.com*''), a 5% ownership interest in the BSE would be valued at approximately $50,000. The Commission believes it unlikely that an entity with total capital of less than $500,000 would be the holder of an ownership interest of such value or, if it did hold such interest, would not be affiliated with an entity (other than a natural person) that is not a small entity.

[742] For example, the Commission believes that the possibility of a small broker or dealer acquiring a 5% interest in the BSE would be greater than the possibility of a small broker or dealer acquiring a 5% interest in the NYSE.

[743] The Commission notes that, if any small entities are required to prepare and file reports pursuant to proposed Rule 17a–27, the Commission estimates that the rule would require: (i) approximately 35 hours per statement to prepare and file the initial statement pursuant to proposed Rule 17a–27(b), including the time required for a member to modify its system for monitoring ownership for purposes of preparing the statement; (ii) approximately 2 hours and $1.29 to prepare and send the copy of the statement or any amendment

Even if a small broker or dealer did not trigger the 5% ownership threshold, it may feel the need to monitor ownership levels. The Commission believes that any system or other changes a small broker or dealer would need to make to monitor ownership interest would not cause a significant economic impact. The Commission believes that given the nature of their business, most members that are brokers or dealers, including those that are small entities, would have in place the necessary systems and procedures for tracking their ownership of securities, both for ownership of entities subject to reporting under Section 13(d) of the Exchange Act and for other entities as well. The Commission preliminarily believes that members could monitor their and their related persons' ownership interests in exchanges, associations and facilities pursuant to these existing systems. The Commission does recognize, however, that members may need to update their systems to meet the scope of the reporting parameters of the proposed rule (for instance, to include all ''related persons''), but preliminarily does not believe that these changes would create a significant economic impact. In addition, a broker or dealer that is considered a small entity likely would have fewer ''related persons'' for which to track ownership. Therefore, the Commission does not believe that proposed Rule 17a–27 would have a ''significant economic impact'' on a substantial number of small entities.

The Commission encourages written comments regarding this certification. The Commission requests that commentators describe the nature of any impact on small entities and provide empirical data to support the extent of the impact. In particular, the Commission requests comments on (a) the number of small entities that would be affected by proposed Rule 17a–27; (b) the nature of any impact the by proposed Rule 17a–27 would have on small entities and empirical data supporting the extent of the impact; and (c) how to quantify the number of small entities that would be affected by or how to quantify the impact of by proposed Rule 17a–27. Commentators are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. Persons wishing to submit written comments should refer to the instructions for submitting comments in the front of this release.

XIV. Statutory Authority and Text of Proposed Rules

Pursuant to the Exchange Act, 15 U.S.C. 78a *et seq.*, and particularly, Sections 3, 6, 11A, 15A, 17, 19, 23(a) and 36(a) thereof, the Commission is proposing to (1) adopt §§ 240.3b–19, 240.6a–5, 240.15Aa–3, 240.17a–26, 240.17a–27 and Regulation AL under the Exchange Act; (2) amend Form 1 and §§ 240.6a–2, 240.15Aa–1 and 240.17a–1 under the Exchange Act; (3) redesignate § 240.15Aj–1 under the Exchange Act as § 240.15Aa–2 and amend newly redesignated § 240.15Aa–2; (4) redesignate Form X–15AA–1 as Form 2 and amend newly redesignated Form 2; and (5) remove Forms X–15AJ–1 and X–15AJ–2.

List of Subjects in 17 CFR Parts 240, 242 and 249

Brokers, Reporting and recordkeeping requirements, Securities.

For the reasons stated in the preamble, the Commission is proposing to amend Title 17, Chapter II of the Code of the Federal Regulations as follows:

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The general authority citation for part 240 is revised to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78k, 78k–1, 78*l*, 78m, 78n, 78o, 78*o*–3, 78p, 78q, 78s, 78u–5, 78w, 78x, 78*ll*, 78mm, 79q, 79t, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

1. Section 240.3b–19 is added to read as follows:

§ 240.3b–19 Definition of rules of an exchange and rules of an association.

(a) *Definitions.* The terms *rules of an exchange* and *rules of an association* shall include the constitution, articles of incorporation, bylaws, and rules, or instruments corresponding to the foregoing, of a regulatory subsidiary of an exchange or of an association of brokers and dealers.

(b) *Exemptions.* Upon written request or on its own motion, the Commission may grant an exemption from the provisions of this section, either unconditionally or on specified terms and conditions, if the Commission determines that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors.

3. Section 240.6a–2 is amended by:

a. Revising paragraphs (a)(2) and paragraphs (b) through (e), and

b. Adding paragraph (a)(3) and new paragraph (g).

The revisions and additions read as follows:

§ 240.6a–2 Amendments to application.

(a) * * *

(2) Information filed as part of Exhibits C, D, E, H, I, J, K, M, N, O, P, S, or U and as part of Item 3 of Exhibit F or Items 1, 5, 6, and 7 of Exhibit Q, or any amendments thereto; or

(3) Information filed as part of Items 2 or 3 of Exhibit Q, or any amendment thereto, except that such information is not required to be filed with respect to any ownership change that is less than one percent from the ownership interest last reported on Form 1 (17 CFR 249.1), or any amendment thereto.

(b) Within 60 days of the end of its fiscal year, a national securities exchange or an exchange exempted from such registration based on limited volume, must submit an amendment to its Form 1 that updates the Form 1 in its entirety. Each Exhibit to the amended Form 1 shall be up to date as of the end of the latest fiscal year of the exchange.

(c) Except as set forth in paragraph (d) of this section, a national securities exchange or an exchange exempted from such registration based on limited volume, must continuously post any amendments required to be filed under paragraphs (a) and (b) of this section on a publicly-accessible Internet web site controlled by the exchange, simultaneous with the filing of such information in paper form with the Commission. Only the most recent annual amendment filed under paragraph (b) of this section and any subsequent updates filed under paragraph (a) of this section are required to be posted on such Internet Web site. In its filing with the Commission, such exchange shall:

(1) Indicate the location of the Internet Web site where such information may be found; and

(2) Certify that the information available at such location is accurate as of its date.

(d)(1) If the information required to be filed under paragraphs (a) or (b) of this section for Exhibits A, B, M, N, S, or T or Items 1–7 of Exhibit L is available continuously on an Internet Web site controlled by an exchange, in lieu of filing such information in paper form

to the applicable exchange or association pursuant to proposed Rule 17a–27(c); and (iii) that each amendment required by proposed Rule 17a–27(b)(4) would require 10 hours per amendment. *See supra* Section IX.G.4. for further discussion of the Commission's estimates of the reporting and recordkeeping burden for proposed Rule 17a–27.

with the Commission, such exchange may:

(i) Indicate the location of the Internet Web site where such information may be found; and

(ii) Certify that the information available at such location is accurate as of its date.

(2) Only the most recent annual amendment required under paragraph (b) of this section and any subsequent updates required under paragraph (a) of this section must be continuously posted on an Internet Web site controlled by an exchange under paragraph (d)(1) of this section.

(e) Upon written request or on its own motion, the Commission may grant an exemption from any of the requirements of this section, either unconditionally or on specified terms and conditions, if the Commission determines that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors.

* * * * *

(g) A national securities exchange shall file as an amendment to Form 1 a complete new statement together with all exhibits which are prescribed to be filed in connection with Form 1 no later than [six months following the date of publication of final rules in the **Federal Register**].

* * * * *

4. Section 240.6a–5 is added to read as follows:

§ 240.6a–5 Fair administration and governance of national securities exchanges.

(a) *General.* Each national securities exchange must comply with, and have rules that comply with, the provisions of this section, and must have the capacity to carry out the purposes of this section. If the national securities exchange has a regulatory subsidiary, the provisions of paragraphs (c), (d), (e), (f), (g), (h), (i), (j), (k), (l), (m), (n), (p) and (q) of this section shall apply to such regulatory subsidiary in the same manner as the national securities exchange; *provided, however,* that to the extent that a Standing Committee of the national securities exchange is authorized to carry out responsibilities on behalf of the regulatory subsidiary, as set forth in its written charter, the regulatory subsidiary shall not be required to have a Standing Committee that performs the same responsibilities and to the extent that the Chief Regulatory Officer of the national securities exchange performs the same responsibilities for the regulatory subsidiary as he or she does for the national securities exchange, the regulatory subsidiary shall not be required to appoint a Chief Regulatory Officer. When used in paragraphs (c), (d), (e), (f), (g), (h), (i), (j), (k), (l), (m), (n), (p) and (q) of this section, the terms ''exchange'' shall also mean the regulatory subsidiary of the exchange; ''Board'' shall also mean the Board of the regulatory subsidiary; ''director'' or ''directors'' shall also mean the directors or directors of the regulatory subsidiary; ''independent director'' or ''independent directors'' shall also mean the independent director or independent directors of the regulatory subsidiary; ''executive session'' shall also mean executive session of the Board of the regulatory subsidiary; and ''Standing Committee'' or ''Standing Committees'' shall also mean the Standing Committee or Standing Committees of the Board of the regulatory subsidiary.

(b) *Definitions.* For purposes of this section, the following definitions shall apply:

(1) The term *affiliate* means any person that, directly or indirectly, controls, is controlled by, or is under common control with, the national securities exchange.

(2) The term *affiliated issuer* means the national securities exchange, an SRO trading facility of the national securities exchange, an affiliate of the national securities exchange, or an affiliate of an SRO trading facility of the national securities exchange.

(3) The term *affiliated security* means any security issued by an affiliated issuer, except that it shall not include any option exempt from the Securities Act of 1933 under § 230.238 of this chapter and any security futures product exempt from the Securities Act of 1933 under section 3(a)(14) of the Securities Act of 1933 (15 U.S.C. 77c(a)(14)).

(4) The terms *beneficial ownership, beneficially owns* or any derivative thereof shall have the same meaning, with respect to any security or other ownership interest, as set forth in § 240.13d–3, as if (and whether or not) such security or other ownership interest were a voting equity security registered under section 12 of the Act (15 U.S.C. 78*l*); provided that to the extent any person beneficially owns any security or other ownership interest solely because such person is a member of a group within the meaning of section 13(d)(3) of the Act (15 U.S.C. 78m(d)(3)), such person shall not be deemed to beneficially own such security or other ownership interest for purposes of this section, unless such person has the power to direct the vote of such security or other ownership interest.

(5) The term *Board* means the Board of Directors or Board of Governors of the national securities exchange, or any equivalent body.

(6) The term *compensation* means any form of compensation and any material perquisites awarded, or that are to be awarded, whether or not set forth in any written documents, to any executive officer of the national securities exchange, including, without limitation, salary, bonus, pension, deferred compensation, compensation awarded pursuant to any incentive plan or equity-based plan, or any other plan, contract, authorization or arrangement pursuant to which cash or securities may be received.

(7) The term *control* means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise. A person is presumed to control another person if the person:

(i) Is a director, general partner or officer exercising executive responsibility (or having similar status or functions);

(ii) Directly or indirectly has the right to vote 25 percent or more of a class of voting securities or has the power to sell or direct the sale of 25 percent or more of a class of voting securities; or

(iii) In the case of a partnership, has the right to receive, upon dissolution, or has contributed, 25 percent or more of the capital.

(8) The term *director* means any member of the Board.

(9) The term *executive session* means a meeting of the independent directors of the Board, without the presence of management of the national securities exchange or the directors who are not independent directors.

(10) The term *facility* has the same meaning as set forth in section 3(a)(2) of the Act (15 U.S.C. 78c(a)(2)).

(11) The term *immediate family member* means a person's spouse, parents, children, and siblings, whether by blood, marriage or adoption, or anyone residing in such person's home.

(12) The term *independent director* means a director who has no material relationship with the national securities exchange or any affiliate of the national securities exchange, any member of the national securities exchange or any affiliate of such member, or any issuer of securities that are listed or traded on the national securities exchange or a facility of the national securities exchange. A director is not independent if any of the following circumstances exists:

(i) The director, or an immediate family member, is employed by or otherwise has a material relationship with the national securities exchange or any affiliate of the national securities exchange, or within the past three years was employed by or otherwise had a material relationship with the national securities exchange or any affiliate of the national securities exchange.

(ii) The director is a member or is employed by or affiliated with a member or any affiliate of a member or, within the past three years was a member or was employed by or affiliated with a member or any affiliate of a member, or the director has an immediate family member that is, or within the past three years was, an executive officer of a member or any affiliate of a member.

(iii) The director, or an immediate family member, has received during any twelve month period within the past three years more than $60,000 in payments from the national securities exchange or any affiliate of the national securities exchange or from a member or any affiliate of a member, other than the following:

(A) Compensation for Board or Board committee service;

(B) Compensation to an immediate family member who is not an executive officer of the national securities exchange or any affiliate of the national securities exchange or of a member or any affiliate of a member; and

(C) Pension and other forms of deferred compensation for prior service, provided such compensation is not contingent in any way on continued service.

(iv) The director, or an immediate family member, is a partner in, or controlling shareholder or executive officer of any organization to which the national securities exchange or any affiliate of the national securities exchange made, or from which the national securities exchange or any affiliate of the national securities exchange received, payments for property or services in the current or any of the past three full fiscal years that exceed two percent of the recipient's consolidated gross revenues for that year, or $200,000, whichever is more, other than the following:

(A) Payments arising solely from investments in the securities of the national securities exchange or any facility or affiliate of the national securities exchange; or

(B) Payments under non-discretionary charitable contribution matching programs.

(v) The director, or an immediate family member, is, or within the past three years was, an executive officer of an issuer of securities listed or primarily traded on the national securities exchange or a facility of the national securities exchange.

(vi) The director, or an immediate family member, is, or within the past three years was, employed as an executive officer of another entity where any of the national securities exchange's executive officers serves on that entity's compensation committee.

(vii) The director, or an immediate family member, is a current partner of the outside auditor of the national securities exchange or any affiliate of the national securities exchange, or was a partner or employee of the outside auditor of the national securities exchange or any affiliate of the national securities exchange who worked on the national securities exchange's or any affiliate's audit, at any time within the past three years.

(viii) In the case of a director that is a member of the Audit Committee, such director (other than in his or her capacity as a member of the Audit Committee, the Board, or any other Board committee), accepts, directly or indirectly, any consulting, advisory, or other compensatory fee from the national securities exchange, any affiliate of the national securities exchange, any member, or any affiliate of a member, other than fixed amounts of pension and other forms of deferred compensation for prior service, provided such compensation is not contingent in any way on continued service.

(13) The term *material relationship* means a relationship, whether compensatory or otherwise, that reasonably could affect the independent judgment or decision-making of the director.

(14) The term *member* has the same meaning as set forth in section 3(a)(3)(A) of the Act (15 U.S.C. 78c(a)(3)(A)).

(15) The term *person* has the same meaning as set forth in section 3(a)(9) of the Act (15 U.S.C. 78c(a)(9)).

(16) The term *person associated with a member* has the same meaning as set forth in section 3(a)(21) of the Act (15 U.S.C. 78c(a)(21)).

(17) The term *regulatory information* means any information collected by a national securities exchange in the course of performing its regulatory obligations under the Act.

(18) The term *regulatory subsidiary* means any person that, directly or indirectly, is controlled by the national securities exchange and that provides, whether pursuant to contract, agreement or rule, regulatory services to or on behalf of the national securities exchange.

(19) The term *related person* means, with respect to any member that is a broker or dealer:

(i) Any affiliate of the member;

(ii) Any person associated with the member;

(iii) Any immediate family member of the member, or any immediate family member of the member's spouse, who, in each case, has the same home as the member or who is a director or officer of the national securities exchange or facility or any of its parents or subsidiaries; and

(iv) Any immediate family member of a person associated with the member, or any immediate family member of such person's spouse, who, in each case, has the same home as the person associated with the member or who is a director or officer of the national securities exchange or facility or any of its parents or subsidiaries.

(20) The term *SRO trading facility* means any facility of a national securities exchange that executes orders in securities.

(21) The term *Standing Committees* means the following committees of the Board: Nominating Committee, Governance Committee, Compensation Committee, Audit Committee, and Regulatory Oversight Committee, or their equivalent.

(c) *Board.* (1) The Board of each national securities exchange must be composed of a majority of independent directors.

(2) No director may qualify as an independent director unless the Board affirmatively determines that the director has no material relationship with the national securities exchange or any affiliate of the national securities exchange. The Board must make this determination upon the director's nomination or appointment to the Board and thereafter no less frequently than annually and as often as necessary in light of the director's circumstances.

(3) The national securities exchange must establish policies and procedures to require each director, on his or her own initiative and upon request of the national securities exchange, to inform the national securities exchange of the existence of any relationship or interest that may reasonably be considered to bear on whether such director is an independent director.

(4) At least 20 percent of the total number of directors must be selected by members.

(5) At least one director must be representative of issuers and at least one director must be representative of investors, and, in each case, such

director must not be associated with a member or broker or dealer.

(6) When the Board considers any matter that is recommended by or otherwise is within the authority or jurisdiction of a Standing Committee, a majority of the directors who vote on the matter must be independent directors.

(7) The national securities exchange must adopt rules establishing a fair process for members to nominate an alternative candidate or candidates to the Board by petition and the percentage of members that is necessary to put forth such alternative candidate or candidates. The percentage of members that is necessary to put forth an alternative candidate or candidates must not exceed 10 percent of the total numbers of members.

(8) If the national securities exchange fails to comply with the requirement that the Board be composed of a majority of independent directors because there is a vacancy on the Board or a director ceases to be independent, it must comply with this requirement by the earlier of its next annual meeting or one year from the date of the occurrence of the event that caused the failure to comply with this requirement.

(9) The national securities exchange must establish procedures for interested persons to communicate their concerns regarding any matter within the authority or jurisdiction of a Standing Committee directly to the independent directors.

(d) *Executive session.* (1) Independent directors of the national securities exchange must meet regularly in executive session.

(2) The independent directors must have the authority to direct and supervise inquiries into any matter brought to their attention within the scope of their duties and to obtain advice and assistance from independent legal counsel and other advisors as they determine necessary to carry out their duties.

(3) The national securities exchange must provide sufficient funding and other resources, as determined by the independent directors, to permit the independent directors to fulfill their responsibilities and to retain independent legal counsel and other advisors.

(e) *Standing Committees of the Board.* (1) The national securities exchange, at a minimum, must have the following Standing Committees of the Board, or their equivalent: Nominating Committee, Governance Committee, Compensation Committee, Audit Committee, and Regulatory Oversight Committee. Each of these Standing Committees must report to the Board.

(2) Each Standing Committee must have the authority to direct and supervise inquiries into any matter brought to its attention within the scope of its duties, and to obtain advice and assistance from independent legal counsel and other advisors as it deems necessary to carry out its duties.

(3) The national securities exchange must provide sufficient funding and other resources, as determined by each Standing Committee, to permit the Standing Committees to fulfill their responsibilities and to retain independent legal counsel and other advisors.

(f) *Nominating Committee.* (1) The Nominating Committee must be composed solely of independent directors.

(2) The Nominating Committee must have a written charter that addresses the Nominating Committee's purpose and responsibilities, which, at a minimum, must be to identify individuals qualified to become Board members, consistent with criteria approved by the Board and administer a process for the nomination of individuals to the Board.

(3) The Nominating Committee must administer a fair process that provides members with the opportunity to select at least 20 percent of the total number of directors. The Nominating Committee must also administer the process established by the exchange under paragraph (c)(7) of this section for the nomination of an alternative candidate or candidates by members through petition.

(4) The Nominating Committee must nominate at least one director who is representative of issuers and at least one director who is representative of investors and who, in each case, is not associated with a member or broker or dealer.

(5) The Nominating Committee must conduct an annual performance self-evaluation.

(g) *Governance Committee.* (1) The Governance Committee must be composed solely of independent directors.

(2) The Governance Committee must have a written charter that addresses the Committee's purpose and responsibilities, which, at a minimum, must be to develop and recommend to the Board a set of governance principles applicable to the national securities exchange and to oversee the evaluation of the Board and management.

(3) The Governance Committee must conduct an annual performance evaluation of the governance of the national securities exchange, including the effectiveness of the Board and its committees.

(h) *Compensation Committee.* (1) The Compensation Committee must be composed solely of independent directors.

(2) The Compensation Committee must have a written charter that addresses the Compensation Committee's purpose and responsibilities, which, at a minimum, must be to have direct responsibility to review and approve corporate goals and objectives relevant to the compensation of the executive officers of the national securities exchange; evaluate the performance of the executive officers in light of those goals and objectives; and consider and approve recommendations with respect to the compensation level of the executive officers, based on this evaluation.

(3) The Compensation Committee must conduct an annual performance self-evaluation.

(i) *Audit Committee.* (1) The Audit Committee must be composed solely of independent directors.

(2) The Audit Committee must have a written charter that addresses the Audit Committee's purpose and responsibilities, which, at a minimum, must be to assist the Board in oversight of the integrity of the national securities exchange's financial statements; the national securities exchange's compliance with related legal and regulatory requirements; and the qualifications and independence of the national securities exchange's auditor, including direct responsibility for the hiring, firing, and compensation of the auditor; overseeing the auditor's engagement; meeting regularly in executive session with the auditor; reviewing the auditor's reports with respect to the national securities exchange's internal controls; pre-approving all audit and non-audit services performed by the auditor; determining the budget and staffing of the national securities exchange's internal audit department; and establishing procedures for the receipt of complaints regarding accounting, internal accounting controls, or auditing matters of the national securities exchange and the confidential submission by employees of the national securities exchange of concerns regarding questionable accounting or auditing matters.

(3) The Audit Committee must conduct an annual performance self-evaluation.

(j) *Regulatory Oversight Committee.* (1) The Regulatory Oversight Committee must be composed solely of independent directors.

(2) The Regulatory Oversight Committee must have a written charter that addresses the Regulatory Oversight Committee's purpose and responsibilities, which, at a minimum, must be to assure the adequacy and effectiveness of the regulatory program of the national securities exchange; assess the exchange's regulatory performance; determine the regulatory plan, programs, budget, and staffing for the regulatory functions of the exchange; assess the performance of, and recommend compensation and personnel actions involving, the Chief Regulatory Officer and other senior regulatory personnel to the Compensation Committee; monitor and review regularly with the Chief Regulatory Officer matters relating to the exchange's surveillance, examination, and enforcement units; assure that the exchange's disciplinary and arbitration proceedings are conducted in accordance with the exchange's rules and policies and any other applicable laws or rules, including those of the Commission; prior to the exchange's approval of an affiliated security for listing, certify that such security meets the exchange's rules for listing; and approve reports filed with the Commission as required by Regulation AL (§ 242.800 of this chapter).

(3) At least 20 percent of the members of any committee, subcommittee, or panel that is responsible for conducting hearings, rendering decisions, and imposing sanctions with respect to disciplinary matters must be members of the national securities exchange.

(4) Any committee, subcommittee, or panel that is responsible for conducting hearings, rendering decisions, and imposing sanctions with respect to disciplinary matters must be subject to the jurisdiction of the Regulatory Oversight Committee.

(5) The Regulatory Oversight Committee must oversee the preparation of the national securities exchange's annual regulatory report, as required by § 240.17a–26.

(6) The Regulatory Oversight Committee must conduct an annual performance self-evaluation.

(k) *Other committees of the Board.* (1) The national securities exchange may establish such other committees of the Board as it deems appropriate. However, if such committee has the authority to act on behalf of the Board, the committee must be composed of a majority of independent directors. The national securities exchange may not delegate to any committee not consisting solely of independent directors the authority to act on matters that otherwise are within the jurisdiction of a Standing Committee.

(2) At least 20 percent of the members of any committee must be members of the national securities exchange if such committee:

(i) Is not a Standing Committee, or is a committee, subcommittee, or panel that is subject to the jurisdiction of a Standing Committee; and

(ii) Is responsible for providing advice with respect to trading rules or disciplinary rules.

(l) *Other requirements applicable to directors and officers.* The rules of the national securities exchange must provide that:

(1) Any person subject to a statutory disqualification as defined in section 3(a)(39) of the Act (15 U.S.C. 78c(a)(39)) shall not be an officer or director of the exchange.

(2) Each director, in discharging his or her responsibilities as a member of the Board, must reasonably consider all requirements applicable to such exchange under the Act.

(m) *Separation of positions of Chairman of the Board and Chief Executive Officer.*

(1) If the Chief Executive Officer of the national securities exchange is not also the Chairman of the Board, the Chairman of the Board must be an independent director.

(2) The Chief Executive Officer must not participate in any executive sessions of the Board.

(3) If a single individual serves as both Chairman of the Board of the national securities exchange and the Chief Executive Officer, the Board must designate an independent director as a lead director to preside over executive sessions of the Board. The Board must publicly disclose such lead director's name and a means by which interested parties may communicate with the lead director.

(4) The Chairman of the Board of the national securities exchange must not serve on the Nominating, Governance, Compensation, Audit, or Regulatory Oversight Committees, unless the Chairman of the Board is an independent director.

(n) *Separation of regulatory and market operations.* (1) The national securities exchange must establish policies and procedures to assure the independence of its regulatory program from its market operations or other commercial interests.

(2) The national securities exchange's regulatory program must be:

(i) Structurally separated from the market operations and other commercial interests of the exchange, by means of separate legal entities; or

(ii) Functionally separated within the same legal entity from the market operations and other commercial interests of the exchange.

(3) The Board must appoint a Chief Regulatory Officer to administer the regulatory program of the national securities exchange. The Chief Regulatory Officer must report directly to the Regulatory Oversight Committee.

(4)(i) Any funds received by the national securities exchange from regulatory fees, fines, or penalties must be applied only to fund programs and operations directly related to such exchange's regulatory responsibilities; and

(ii) The national securities exchange must make and keep books and records necessary to demonstrate compliance with the requirement in paragraph (n)(4)(i) of this section.

(5)(i) A national securities exchange must establish policies and procedures reasonably designed to:

(A) Prevent the dissemination of regulatory information to any person other than an officer, director, employee, or agent of the exchange directly involved in carrying out the exchange's regulatory obligations under the Act;

(B) Prevent the use of regulatory information for any purpose other than carrying out the exchange's regulatory obligations under the Act; and

(C) Maintain the confidentiality of any information required to be submitted to effectuate a transaction on or through such exchange or its facilities, unless such information is aggregated to such an extent that no person whose information is included in the aggregated information can be identified, or unless the person has consented to the dissemination and use of its information by the exchange.

(ii) An exchange's policies and procedures must require its officers, directors, employees, and agents to agree to comply with the requirements of paragraph (n)(5)(i) of this section.

(o) *Limits on member ownership and voting.* (1) The rules of a national securities exchange must prohibit any member of such exchange that is a broker or dealer, alone or together with its related persons, from either:

(i) Beneficially owning, directly or indirectly, any interest in the national securities exchange or a facility of such exchange through which the member is permitted to effect transactions that exceeds 20 percent of any class of securities or other ownership interest of such national securities exchange or facility; or

(ii) Directly or indirectly voting, causing the voting of, or giving any

consent or proxy with respect to the voting of, any interest in the national securities exchange or a facility of such exchange through which the member is permitted to effect transactions that exceeds 20 percent of the voting power of any class of securities or other ownership interest of such national securities exchange or facility.

(2) The prohibition in paragraph (o)(1)(ii) shall not apply to any solicitation or receipt of a revocable proxy by any member that is a broker or dealer or its related persons from other shareholders of the national securities exchange or facility that is conducted pursuant to, and in accordance with, Regulation 14A under the Act (15 U.S.C. 78n), except that a member and its related persons may not conduct a solicitation or receive a proxy pursuant to § 240.14a–2(b)(2) with regard to or from a person or persons whose interest in the national securities exchange or facility, together with the member's and its related person's aggregate interest, would exceed the voting limitation in paragraph (o)(1) of this section.

(3) The rules of the national securities exchange must provide an effective mechanism to divest any member that is a broker or dealer and its related persons of any interest owned in excess of the ownership limitation in paragraph (o)(1) of this section.

(4) The rules of the national securities exchange must be reasonably designed to not give effect to the portion of a vote by a member that is a broker or dealer and its related persons that is in excess of the voting limitation in paragraph (o)(1) of this section.

(5) The rules of the national securities exchange must provide an effective mechanism for the national securities exchange to obtain information relating to ownership and voting interests in the national securities exchange or any facility of the national securities exchange from any owner of any interest.

(p) *Code of conduct and ethics.* (1) The rules of the national securities exchange must provide:

(i) For a code of conduct and ethics for directors, officers and employees that, at a minimum, establishes policies and procedures regarding: conflicts of interest; corporate opportunities; confidentiality; fair dealing; protection and proper use of the exchange's assets; compliance with laws, rules, and regulations by directors, officers and employees; and the reporting of illegal or unethical behavior; and

(ii) That any waiver of the code of conduct and ethics established under paragraph (p)(1)(i) of this section must be approved by the Board.

(2) The rules of the national securities exchange must prohibit any of its employees or officers from being a member of the board of directors of a listed issuer or member firm.

(q) *Governance guidelines.* The national securities exchange must adopt rules implementing governance guidelines that, at a minimum, establish policies regarding: director qualification standards; director responsibilities; director access to management and independent advisors; director compensation; director orientation and continuing education; management succession; and annual performance evaluations of the Board.

(r) *Implementation.* (1) The rules of each national securities exchange must be designed to meet the requirements of this section and must be operative no later than [one year following the date of publication of final rules in the **Federal Register**].

(2) Each national securities exchange must submit to the Commission a proposed rule change that complies with this section no later than [four months following the date of publication of final rules in the **Federal Register**].

(3) Each national securities exchange must have final rules that comply with this section approved by the Commission no later than [ten months following the date of publication of final rules in the **Federal Register**].

(s) *Exemptions.* (1) A national securities exchange registered pursuant to section 6(g)(1) of the Act (15 U.S.C. 78f(g)(1)) is exempt from the requirements of this section.

(2) Upon written request or on its own motion, the Commission may grant an exemption from any provision of this section, either unconditionally or on specified terms and conditions, if the Commission determines that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors.

§ 240.15Aa–1 [Amended]

5. Section 240.15Aa–1 is amended by revising the reference to ''Form X–15AA–1'' to read ''Form 2''.

§ 240.15Aj–1 [Removed]

6. Section 240.15Aj–1 is removed.

7. Section 240.15Aa–2 is added to read as follows:

§ 240.15Aa–2. Amendments to application.

(a) A registered securities association or an affiliated securities association shall file an amendment to Form 2, which shall set forth the nature and effective date of the action taken, and shall provide any new information and correct any information rendered inaccurate on Form 2, within 10 calendar days after any material event takes place that renders inaccurate, or that causes to be incomplete, any of the following:

(1) Information filed on the Execution Page of Form 2, or amendment thereto;

(2) Information filed as part of Exhibits C, D, E, H, I, J, K, M, N, O, P, S, or U and as part of Item 3 of Exhibit F or Items 1, 5, 6, and 7 of Exhibit Q, or any amendments thereto; or

(3) Information filed as part of Items 2 or 3 of Exhibit Q, or any amendment thereto, except that such information is not required to be filed with respect to any ownership change that is less than one percent from the ownership interest last reported on Form 2, or any amendment thereto.

(b) Within 60 days of the end of its fiscal year, a registered securities association or an affiliated securities association must submit an amendment to its Form 2 that updates the Form 2 in its entirety. Each Exhibit to the amended Form 2 shall be up to date as of the end of the latest fiscal year of the association.

(c) Except as set forth in paragraph (d) of this section, a registered securities association or an affiliated securities association must continuously post any amendments required to be filed under paragraphs (a) and (b) of this section on a publicly-accessible Internet web site controlled by the association, simultaneous with the filing of such information in paper form with the Commission. Only the most recent annual amendment filed under paragraph (b) of this section and any subsequent updates filed under paragraphs (a) of this section are required to be posted on such Internet web site. In its filing with the Commission, such association shall:

(1) Indicate the location of the Internet web site where such information may be found; and

(2) Certify that the information available at such location is accurate as of its date.

(d)(1) If the information required to be filed under paragraphs (a) or (b) of this section for Exhibits A, B, M, N, S, or T or Items 1–7 of Exhibit L is available continuously on an Internet web site controlled by an association, in lieu of filing such information in paper form with the Commission, such association may:

(i) Indicate the location of the Internet web site where such information may be found; and

(ii) Certify that the information available at such location is accurate as of its date.

(2) Only the most recent annual amendment required under paragraph (b) of this section and any subsequent updates required under paragraph (a) of this section must be continuously posted on an Internet web site controlled by an association under paragraph (d)(1) of this section.

(e) Upon written request or on its own motion, the Commission may grant an exemption from any of the requirements of this section, either unconditionally or on specified terms and conditions, if the Commission determines that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors.

(f) A registered securities association or an affiliated securities association shall file as an amendment to Form 2 a complete new statement together will all exhibits which are prescribed to be filed in connection with Form 2 no later than [six months following the date of publication of final rules in the **Federal Register**].

8. Section 240.15Aa–3 is added to read as follows:

§ 240.15Aa–3 Fair administration and governance of registered securities associations.

(a) *General.* Each association must comply with, and have rules that comply with, the provisions of this section, and must have the capacity to carry out the purposes of this section. If the association has a regulatory subsidiary, the provisions of paragraphs (c), (d), (e), (f), (g), (h), (i), (j), (k), (l), (m), (n), (p) and (q) of this section shall apply to such regulatory subsidiary in the same manner as the association; *provided, however,* that to the extent that a Standing Committee of the association is authorized to carry out responsibilities on behalf of the regulatory subsidiary, as set forth in its written charter, the regulatory subsidiary shall not be required to have a Standing Committee that performs the same responsibilities and to the extent that the Chief Regulatory Officer of the association performs the same responsibilities for the regulatory subsidiary as he or she does for the association, the regulatory subsidiary shall not be required to appoint a Chief Regulatory Officer. When used in paragraphs (c), (d), (e), (f), (g), (h), (i), (j), (k), (l), (m), (n), (p) and (q) of this section, the terms ''association'' shall also mean the regulatory subsidiary of the association; ''Board'' shall also mean the Board of the regulatory subsidiary; ''director'' or ''directors'' shall also mean the directors or directors of the regulatory subsidiary; ''independent director'' or ''independent directors'' shall also mean the independent director or independent directors of the regulatory subsidiary; ''executive session'' shall also mean executive session of the Board of the regulatory subsidiary; and ''Standing Committee'' or ''Standing Committees'' shall also mean the Standing Committee or Standing Committees of the Board of the regulatory subsidiary.

(b) *Definitions.* For purposes of this section, the following definitions shall apply:

(1) The term *affiliate* means any person that, directly or indirectly, controls, is controlled by, or is under common control with, the association.

(2) The term *affiliated issuer* means the association, an SRO trading facility of the association, an affiliate of the association, or an affiliate of an SRO trading facility of the association.

(3) The term *affiliated security* means any security issued by an affiliated issuer, except that it shall not include any option exempt from the Securities Act of 1933 under § 230.238 of this chapter and any security futures product exempt from the Securities Act of 1933 under section 3(a)(14) of the Securities Act of 1933 (15 U.S.C. 77c(a)(14)).

(4) The term *association* means any association registered under section 15A of the Act (15 U.S.C. 78*o*–3).

(5) The terms *beneficial ownership, beneficially owns* or any derivative thereof shall have the same meaning, with respect to any security or other ownership interest, as set forth in § 240.13d–3, as if (and whether or not) such security or other ownership interest were a voting equity security registered under section 12 of the Act (15 U.S.C. 78*l*); *provided that* to the extent any person beneficially owns any security or other ownership interest solely because such person is a member of a group within the meaning of section 13(d)(3) of the Act (15 U.S.C. 78m(d)(3)), such person shall not be deemed to beneficially own such security or other ownership interest for purposes of this section, unless such person has the power to direct the vote of such security or other ownership interest.

(6) The term *Board* means the Board of Directors or Board of Governors of the association, or any equivalent body.

(7) The term *compensation* means any form of compensation and any material perquisites awarded, or that are to be awarded, whether or not set forth in any written documents, to any executive officer of the association, including, without limitation, salary, bonus, pension, deferred compensation, compensation awarded pursuant to any incentive plan or equity-based plan, or any other plan, contract, authorization or arrangement pursuant to which cash or securities may be received.

(8) The term *control* means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise. A person is presumed to control another person if the person:

(i) Is a director, general partner or officer exercising executive responsibility (or having similar status or functions);

(ii) Directly or indirectly has the right to vote 25 percent or more of a class of voting securities or has the power to sell or direct the sale of 25 percent or more of a class of voting securities; or

(iii) In the case of a partnership, has the right to receive, upon dissolution, or has contributed, 25 percent or more of the capital.

(9) The term *director* means any member of the Board.

(10) The term *executive session* means a meeting of the independent directors of the Board, without the presence of management of the association or the directors who are not independent directors.

(11) The term *facility* when used with respect to an association includes its premises, tangible or intangible property whether on the premises or not, any right to the use of such premises or property or any service thereof for the purpose of effecting or reporting a transaction (including, among other things, any system of communication to or from the association, by ticker or otherwise, maintained by or with the consent of the association), and any right of the association to the use of any property or service.

(12) The term *immediate family member* means a person's spouse, parents, children, and siblings, whether by blood, marriage or adoption, or anyone residing in such person's home.

(13) The term *independent director* means a director who has no material relationship with the association or any affiliate of the association, any member of the association or any affiliate of such member, or any issuer of securities that are listed or traded on a facility of the association. A director is not independent if any of the following circumstances exists:

(i) The director, or an immediate family member, is employed by or otherwise has a material relationship with the association or any affiliate of the association, or within the past three years was employed by or otherwise had a material relationship with the

association or any affiliate of the association.

(ii) The director is a member or is employed by or affiliated with a member or any affiliate of a member or, within the past three years was a member or was employed by or affiliated with a member or any affiliate of a member, or the director has an immediate family member that is, or within the past three years was, an executive officer of a member or any affiliate of a member.

(iii) The director, or an immediate family member, has received during any twelve month period within the past three years more than $60,000 in payments from the association or any affiliate of the association or from a member or any affiliate of a member, other than the following:

(A) Compensation for Board or Board committee service;

(B) Compensation to an immediate family member who is not an executive officer of the association or any affiliate of the association or of a member or any affiliate of a member; and

(C) Pension and other forms of deferred compensation for prior service, provided such compensation is not contingent in any way on continued service.

(iv) The director, or an immediate family member, is a partner in, or controlling shareholder or executive officer of any organization to which the association or any affiliate of the association made, or from which the association or any affiliate of the association received, payments for property or services in the current or any of the past three full fiscal years that exceed two percent of the recipient's consolidated gross revenues for that year, or $200,000, whichever is more, other than the following:

(A) Payments arising solely from investments in the securities of the association or any facility or affiliate of the association; or

(B) Payments under non-discretionary charitable contribution matching programs.

(v) The director, or an immediate family member, is, or within the past three years was, an executive officer of an issuer of securities listed or primarily traded on a facility of the association.

(vi) The director, or an immediate family member, is, or within the past three years was, employed as an executive officer of another entity where any of the association's executive officers serves on that entity's compensation committee.

(vii) The director, or an immediate family member, is a current partner of the outside auditor of the association or any affiliate of the association, or was a partner or employee of the outside auditor of the association or any affiliate of the association who worked on the association's or any affiliate's audit, at any time within the past three years.

(viii) In the case of a director that is a member of the Audit Committee, such director (other than in his or her capacity as a member of the Audit Committee, the Board, or any other Board committee), accepts, directly or indirectly, any consulting, advisory, or other compensatory fee from the association, any affiliate of the association, any member, or any affiliate of a member, other than fixed amounts of pension and other forms of deferred compensation for prior service, provided such compensation is not contingent in any way on continued service.

(14) The term *material relationship* means a relationship, whether compensatory or otherwise, that reasonably could affect the independent judgment or decision-making of the director.

(15) The term *member* has the same meaning as set forth in section 3(a)(3)(B) of the Act (15 U.S.C. 78c(a)(3)(B)).

(16) The term *person* has the same meaning as set forth in section 3(a)(9) of the Act (15 U.S.C. 78c(a)(9)).

(17) The term *person associated with a member* has the same meaning as set forth in section 3(a)(21) of the Act (15 U.S.C. 78c(a)(21)).

(18) The term *regulatory information* means any information collected by an association in the course of performing its regulatory obligations under the Act.

(19) The term *regulatory subsidiary* means any person that, directly or indirectly, is controlled by the association and that provides, whether pursuant to contract, agreement or rule, regulatory services to or on behalf of the association.

(20) The term *related person* means, with respect to any member:

(i) Any affiliate of the member;

(ii) Any person associated with the member;

(iii) Any immediate family member of the member, or any immediate family member of the member's spouse, who, in each case, has the same home as the member or who is a director or officer of the association or facility or any of its parents or subsidiaries; and

(iv) Any immediate family member of a person associated with the member, or any immediate family member of such person's spouse, who, in each case, has the same home as the person associated with the member or who is a director or officer of the association or facility or any of its parents or subsidiaries.

(21) The term *SRO trading facility* means any facility of an association that executes orders in securities.

(22) The term *Standing Committees* means the following committees of the Board: Nominating Committee, Governance Committee, Compensation Committee, Audit Committee, and Regulatory Oversight Committee, or their equivalent.

(c) *Board.* (1) The Board of each association must be composed of a majority of independent directors.

(2) No director may qualify as an independent director unless the Board affirmatively determines that the director has no material relationship with the association or any affiliate of the association. The Board must make this determination upon the director's nomination or appointment to the Board and thereafter no less frequently than annually and as often as necessary in light of the director's circumstances.

(3) The association must establish policies and procedures to require each director, on his or her own initiative and upon request of the association, to inform the association of the existence of any relationship or interest that may reasonably be considered to bear on whether such director is an independent director.

(4) At least 20 percent of the total number of directors must be selected by members.

(5) At least one director must be representative of issuers and at least one director must be representative of investors, and, in each case, such director must not be associated with a member or broker or dealer.

(6) When the Board considers any matter that is recommended by or otherwise is within the authority or jurisdiction of a Standing Committee, a majority of the directors who vote on the matter must be independent directors.

(7) The association must adopt rules establishing a fair process for members to nominate an alternative candidate or candidates to the Board by petition and the percentage of members that is necessary to put forth such alternative candidate or candidates. The percentage of members that is necessary to put forth an alternative candidate or candidates must not exceed 10 percent of the total numbers of members.

(8) If the association fails to comply with the requirement that the Board be composed of a majority of independent directors because there is a vacancy on the Board or a director ceases to be independent, it must comply with this requirement by the earlier of its next annual meeting or one year from the date of the occurrence of the event that

caused the failure to comply with this requirement.

(9) The association must establish procedures for interested persons to communicate their concerns regarding any matter within the authority or jurisdiction of a Standing Committee directly to the independent directors.

(d) *Executive session.* (1) Independent directors of the association must meet regularly in executive session.

(2) The independent directors must have the authority to direct and supervise inquiries into any matter brought to their attention within the scope of their duties and to obtain advice and assistance from independent legal counsel and other advisors as they determine necessary to carry out their duties.

(3) The association must provide sufficient funding and other resources, as determined by the independent directors, to permit the independent directors to fulfill their responsibilities and to retain independent legal counsel and other advisors.

(e) *Standing Committees of the Board.* (1) The association, at a minimum, must have the following Standing Committees of the Board, or their equivalent: Nominating Committee, Governance Committee, Compensation Committee, Audit Committee, and Regulatory Oversight Committee. Each of these Standing Committees must report to the Board.

(2) Each Standing Committee must have the authority to direct and supervise inquiries into any matter brought to its attention within the scope of its duties, and to obtain advice and assistance from independent legal counsel and other advisors as it deems necessary to carry out its duties.

(3) The association must provide sufficient funding and other resources, as determined by each Standing Committee, to permit the Standing Committees to fulfill their responsibilities and to retain independent legal counsel and other advisors.

(f) *Nominating Committee.* (1) The Nominating Committee must be composed solely of independent directors.

(2) The Nominating Committee must have a written charter that addresses the Nominating Committee's purpose and responsibilities, which, at a minimum, must be to identify individuals qualified to become Board members, consistent with criteria approved by the Board and administer a process for the nomination of individuals to the Board.

(3) The Nominating Committee must administer a fair process that provides members with the opportunity to select at least 20 percent of the total number of directors. The Nominating Committee must also administer the process established by the association under paragraph (c)(7) of this section for the nomination of an alternative candidate or candidates by members through petition.

(4) The Nominating Committee must nominate at least one director who is representative of issuers and at least one director who is representative of investors and who, in each case, is not associated with a member or broker or dealer.

(5) The Nominating Committee must conduct an annual performance self-evaluation.

(g) *Governance Committee.* (1) The Governance Committee must be composed solely of independent directors.

(2) The Governance Committee must have a written charter that addresses the Committee's purpose and responsibilities, which, at a minimum, must be to develop and recommend to the Board a set of governance principles applicable to the association and to oversee the evaluation of the Board and management.

(3) The Governance Committee must conduct an annual performance evaluation of the governance of the association, including the effectiveness of the Board and its committees.

(h) *Compensation Committee.* (1) The Compensation Committee must be composed solely of independent directors.

(2) The Compensation Committee must have a written charter that addresses the Compensation Committee's purpose and responsibilities, which, at a minimum, must be to have direct responsibility to review and approve corporate goals and objectives relevant to the compensation of the executive officers of the association; evaluate the performance of the executive officers in light of those goals and objectives; and consider and approve recommendations with respect to the compensation level of the executive officers, based on this evaluation.

(3) The Compensation Committee must conduct an annual performance self-evaluation.

(i) *Audit Committee.* (1) The Audit Committee must be composed solely of independent directors.

(2) The Audit Committee must have a written charter that addresses the Audit Committee's purpose and responsibilities, which, at a minimum, must be to assist the Board in oversight of the integrity of the association's financial statements; the association's compliance with related legal and regulatory requirements; and the qualifications and independence of the association's auditor, including direct responsibility for the hiring, firing, and compensation of the auditor; overseeing the auditor's engagement; meeting regularly in executive session with the auditor; reviewing the auditor's reports with respect to the association's internal controls; pre-approving all audit and non-audit services performed by the auditor; determining the budget and staffing of the association's internal audit department; and establishing procedures for the receipt of complaints regarding accounting, internal accounting controls, or auditing matters of the association and the confidential submission by employees of the association of concerns regarding questionable accounting or auditing matters.

(3) The Audit Committee must conduct an annual performance self-evaluation.

(j) *Regulatory Oversight Committee.* (1) The Regulatory Oversight Committee must be composed solely of independent directors.

(2) The Regulatory Oversight Committee must have a written charter that addresses the Regulatory Oversight Committee's purpose and responsibilities, which, at a minimum, must be to assure the adequacy and effectiveness of the regulatory program of the association; assess the association's regulatory performance; determine the regulatory plan, programs, budget, and staffing for the regulatory functions of the association; assess the performance of, and recommend compensation and personnel actions involving, the Chief Regulatory Officer and other senior regulatory personnel to the Compensation Committee; monitor and review regularly with the Chief Regulatory Officer matters relating to the association's surveillance, examination, and enforcement units; assure that the association's disciplinary and arbitration proceedings are conducted in accordance with the association's rules and policies and any other applicable laws or rules, including those of the Commission; prior to the association's approval of an affiliated security for listing, certify that such security meets the association's rules for listing; and approve reports filed with the Commission as required by Regulation AL (§ 242.800 of this chapter).

(3) At least 20 percent of the members of any committee, subcommittee, or panel that is responsible for conducting hearings, rendering decisions, and

imposing sanctions with respect to disciplinary matters must be members of the association.

(4) Any committee, subcommittee, or panel that is responsible for conducting hearings, rendering decisions, and imposing sanctions with respect to disciplinary matters must be subject to the jurisdiction of the Regulatory Oversight Committee.

(5) The Regulatory Oversight Committee must oversee the preparation of the association's annual regulatory report, as required by § 240.17a–26.

(6) The Regulatory Oversight Committee must conduct an annual performance self-evaluation.

(k) *Other committees of the Board.* (1) The association may establish such other committees of the Board as it deems appropriate. However, if such committee has the authority to act on behalf of the Board, the committee must be composed of a majority of independent directors. The association may not delegate to any committee not consisting solely of independent directors the authority to act on matters that otherwise are within the jurisdiction of a Standing Committee.

(2) At least 20 percent of the members of any committee must be members of the association if such committee:

(i) Is not a Standing Committee, or is a committee, subcommittee, or panel that is subject to the jurisdiction of a Standing Committee; and

(ii) Is responsible for providing advice with respect to trading rules or disciplinary rules.

(l) *Other requirements applicable to directors and officers.* The rules of the association must provide that:

(1) Any person subject to a statutory disqualification as defined in section 3(a)(39) of the Act (15 U.S.C. 78c(a)(39)) shall not be an officer or director of the association.

(2) Each director, in discharging his or her responsibilities as a member of the Board, must reasonably consider all requirements applicable to such association under the Act.

(m) *Separation of positions of Chairman of the Board and Chief Executive Officer.* (1) If the Chief Executive Officer of the association is not also the Chairman of the Board, the Chairman of the Board must be an independent director.

(2) The Chief Executive Officer must not participate in any executive sessions of the Board.

(3) If a single individual serves as both Chairman of the Board of the association and the Chief Executive Officer, the Board must designate an independent director as a lead director to preside over executive sessions of the Board. The Board must publicly disclose such lead director's name and a means by which interested parties may communicate with the lead director.

(4) The Chairman of the Board of the association must not serve on the Nominating, Governance, Compensation, Audit, or Regulatory Oversight Committees, unless the Chairman of the Board is an independent director.

(n) *Separation of regulatory and market operations.* (1) The association must establish policies and procedures to assure the independence of its regulatory program from its market operations or other commercial interests.

(2) The association's regulatory program must be:

(i) Structurally separated from the market operations and other commercial interests of the association, by means of separate legal entities; or

(ii) Functionally separated within the same legal entity from the market operations and other commercial interests of the association.

(3) The Board must appoint a Chief Regulatory Officer to administer the regulatory program of the association. The Chief Regulatory Officer must report directly to the Regulatory Oversight Committee.

(4)(i) Any funds received by the association from regulatory fees, fines, or penalties must be applied only to fund programs and operations directly related to such association's regulatory responsibilities; and

(ii) The association must make and keep books and records necessary to demonstrate compliance with the requirement in paragraph (n)(4)(i) of this section.

(5)(i) An association must establish policies and procedures reasonably designed to:

(A) Prevent the dissemination of regulatory information to any person other than an officer, director, employee, or agent of the association directly involved in carrying out the association's regulatory obligations under the Act;

(B) Prevent the use of regulatory information for any purpose other than carrying out the association's regulatory obligations under the Act; and

(C) Maintain the confidentiality of any information required to be submitted to effectuate a transaction on or through such association or its facilities, unless such information is aggregated to such an extent that no person whose information is included in the aggregated information can be identified, or unless the person has consented to the dissemination and use of its information by the association.

(ii) An association's policies and procedures must require its officers, directors, employees, and agents to agree to comply with the requirements of paragraph (n)(5)(i) of this section.

(o) *Limits on member ownership and voting.* (1) The rules of an association must prohibit any member of such association, alone or together with its related persons, from either:

(i) Beneficially owning, directly or indirectly, any interest in the association or a facility of such association through which the member is permitted to effect transactions that exceeds 20 percent of any class of securities or other ownership interest of such association or facility; or

(ii) Directly or indirectly voting, causing the voting of, or giving any consent or proxy with respect to the voting of, any interest in the association or a facility of such association through which the member is permitted to effect transactions that exceeds 20 percent of the voting power of any class of securities or other ownership interest of such association or facility.

(2) The prohibition in paragraph (o)(1)(ii) shall not apply to any solicitation or receipt of a revocable proxy by any member or its related persons from other shareholders of the association or facility that is conducted pursuant to, and in accordance with, Regulation 14A under the Act (15 U.S.C. 78n), except that a member and its related persons may not conduct a solicitation or receive a proxy pursuant to § 240.14a–2(b)(2) with regard to or from a person or persons whose interest in the association or facility, together with the member's and its related person's aggregate interest, would exceed the voting limitation in paragraph (o)(1) of this section.

(3) The rules of the association must provide an effective mechanism to divest any member and its related persons of any interest owned in excess of the ownership limitation in paragraph (o)(1) of this section.

(4) The rules of the association must be reasonably designed to not give effect to the portion of a vote by a member and its related persons that is in excess of the voting limitation in paragraph (o)(1) of this section.

(5) The rules of the association must provide an effective mechanism for the association to obtain information relating to ownership and voting interests in the association or any facility of the association from any owner of any interest.

(p) *Code of conduct and ethics.* (1) The rules of the association must provide:

(i) For a code of conduct and ethics for directors, officers and employees that, at a minimum, establishes policies and procedures regarding: conflicts of interest; corporate opportunities; confidentiality; fair dealing; protection and proper use of the association's assets; compliance with laws, rules, and regulations by directors, officers and employees; and the reporting of illegal or unethical behavior; and

(ii) That any waiver of the code of conduct and ethics established under paragraph (p)(1)(i) of this section must be approved by the Board.

(2) The rules of the association must prohibit any of its employees or officers from being a member of the board of directors of a listed issuer or member firm.

(q) *Governance guidelines.* The association must adopt rules implementing governance guidelines that, at a minimum, establish policies regarding: director qualification standards; director responsibilities; director access to management and independent advisors; director compensation; director orientation and continuing education; management succession; and annual performance evaluations of the Board.

(r) *Implementation.* (1) The rules of each association must be designed to meet the requirements of this section and must be operative no later than [one year following the date of publication of final rules in the **Federal Register**].

(2) Each association must submit to the Commission a proposed rule change that complies with this section no later than [four months following the date of publication of final rules in the **Federal Register**].

(3) Each association must have final rules that comply with this section approved by the Commission no later than [ten months following the date of publication of final rules in the **Federal Register**].

(s) *Exemptions.* (1) A limited purpose national securities association registered pursuant to section 15A(k)(1) of the Act (15 U.S.C. 78*o*–3(k)(1)), is exempt from the requirements of this section.

(2) Upon written request or on its own motion, the Commission may grant an exemption from any provision of this section, either unconditionally or on specified terms and conditions, if the Commission determines that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors.

9. Section 240.17a–1 is amended by revising paragraph (b) to read as follows:

§ 240.17a–1 Recordkeeping rule for national securities exchanges, national securities associations, registered clearing agencies and the Municipal Securities Rulemaking Board.

* * * * *

(b) Every national securities exchange, national securities association, registered clearing agency and the Municipal Securities Rulemaking Board shall keep all such documents for a period of not less than five years at a place within the United States, the first two in an easily accessible place, subject to the destruction and disposition provisions in § 240.17a-6.

* * * * *

10. Section 240.17a–26 is added to read as follows:

§ 240.17a–26 Regulatory reports of national securities exchanges and registered securities associations.

(a)(1) *Quarterly and annual reports.* Every national securities exchange and every registered securities association must file with the Commission reports, in electronic format, prepared by the exchange or association containing the information required by paragraph (b) of this section. Unless otherwise noted, the information specified in paragraph (b)(2) of this section must be filed on a quarterly basis within 20 business days after the end of each calendar quarter. In addition, an annual report containing the information specified in paragraphs (a)(2), (b)(2)(i) through (b)(2)(vii), and (b)(3) of this section must be filed on an annual basis within 60 calendar days after the year end.

(2) *Electronic SRO trading facilities.* Every national securities exchange and registered securities association that owns, operates, or sponsors an electronic SRO trading facility must file, as part of the annual report, a report of an independent audit designed to assess whether the operations of any electronic SRO trading facility of the exchange or association comply with the rules governing such facility. The report must be prepared by a third party not affiliated with the exchange or association that is qualified to render an opinion on such matters.

(b)(1)(i) *Scope.* The quarterly and annual reports required by paragraph (a) of this section must include the information specified in paragraphs (b)(2) and (b)(3) of this section, relating to the regulatory program of the national securities exchange or registered securities association and any affiliate, including any surveillance, examination, and disciplinary programs. In the event that the exchange or association has entered into a contract or agreement with a regulatory subsidiary or with another self-regulatory organization pursuant to which such regulatory subsidiary or other self-regulatory organization provides regulatory services to or on behalf of the exchange or association, the information required by paragraph (b) of this section must include the information relating to the regulatory subsidiary's or other self-regulatory organization's activities on behalf of the exchange or association. In addition, the quarterly and annual reports must contain information, including surveillance reporting, both for those members for which the exchange or association is the designated examining authority and for any other members that use any facility of the exchange or association.

(ii) *Uniform format.* Every national securities exchange and registered securities association subject to this section shall establish procedures for the preparation of the quarterly and annual reports required by this section in a uniform, readily accessible, and usable electronic format, review the reporting procedures from time to time to evaluate their efficacy, and revise the procedures as necessary.

(2) *Quarterly reports.* The following information must be filed with the Commission by every national securities exchange and registered securities association on a quarterly basis:

(i) Results of the surveillance programs, both manual and automated, during the reporting period, including, but not limited to: The number of exception reports and alerts generated, sorted by applicable rule or category; the number of exception reports and alerts reviewed by the exchange or association; and the number of exception reports and alerts closed or referred for further investigation or for enforcement proceedings;

(ii) Results of surveillance programs relating to financial and operational requirements of members and other entities over which the exchange or association exercises examining authority during the reporting period, including, but not limited to: A list of member firms with net capital computation errors exceeding ten percent of excess net capital, using a unique identifier specific to the member firm to identify such member firm, and a factual description of any action taken by the exchange or association in response thereto; a list of member firms that filed late reports on Form X–17A–5 under § 240.17a–5(a), using a unique identifier specific to the member firm to identify such member firm, and a factual description of any action taken by the exchange or association in

response thereto; and a list of member firms that filed amendments to their reports on Form X–17A–5 under § 240.17a–5(a), using a unique identifier specific to the member firm to identify such member firm, and a factual description of any action taken by the exchange or association in response thereto;

(iii) A summary of all complaints relating to the exchange's or association's regulatory program received during the reporting period from any source, grouped by subject matter and using a unique identifier specific to the member and any associated person(s) involved; and including the date the complaint was received; the type of source from which the complaint originated; and a factual description of any response or action taken by the exchange or association in response to the complaint, including any disposition of the matter and the date of any response;

(iv) A summary of all investigations opened, closed, and pending during the reporting period including the aggregate number of investigations for each such category, and a summary of the facts of each investigation including, but not limited to: The member firm and any associated person(s) under review using a unique identifier specific to the member firm and associated person(s) under review; a factual description of any alleged violations; the type of source that led to the investigation; a factual description of the matter under investigation and the relevant security symbol or specific type of security involved; the date of the occurrence of the matter under investigation and the date it was reported or detected; the date the investigation was opened and, as applicable, closed; the length of time the investigation has been or was open; and, if applicable, a factual description of the recommendations and disposition of the investigation. In addition, the report should include a summary of the number of investigations conducted during the reporting period and the average elapsed time, in days, for all investigations closed during the reporting period;

(v) A summary of all examinations opened, closed, and pending during the reporting period including the aggregate number of examinations for each such category, and a summary of the facts of each examination including, but not limited to: A list of the members examined during the reporting period using a unique identifier specific to the member firm; the frequency with which each such member is examined; the type of examination, including whether the examination was a cycle or for-cause examination and a factual description of any reasons for a cause examination; whether the examination was of a new member and, if so, the date the member was registered under the Act and the date the examination of the new member commenced; a factual description of the scope and subject matter of such examination; the date the examination was opened and, as applicable, closed; the length of time the examination has been or was open; whether the examination included an on-site branch examination; a factual description of any potential violations; and, if applicable, a factual description of the recommendations and disposition of the examination. In addition, the report should include a summary of the number of examinations conducted during the reporting period and the average elapsed time, in days, for all examinations closed during the reporting period;

(vi) A summary of all enforcement cases opened, closed, and pending during the reporting period including the aggregate number of enforcement cases in each category, grouped by subject matter, and a summary of the facts of each case including, but not limited to: The member firm and any associated person(s) under review using a unique identifier specific to the member firm and associated person(s) under review; the type of source that led to the case; a factual description of any alleged violations and, as applicable, the relevant security symbol or specific type of security involved; the date of the occurrence of any alleged violations and the date they were reported or detected; the date the enforcement case was opened and, as applicable, closed; the length of time the case has been or was open; and, if applicable, a factual description of the disposition of the case, including whether the case was settled and any sanctions imposed. In addition, the report should include a summary of the number of enforcement cases conducted during the reporting period and the average elapsed time, in days, for all enforcement cases closed during the reporting period;

(vii) A summary of listings information during the reporting period, including, but not limited to: A list of all securities that were newly listed or were delisted during the reporting period, including the name, symbol, and issuer; a list of all issuers to whom the exchange or association, or a facility thereof, sent during the reporting period a notice alleging that such issuer does not satisfy a rule or standard for continued listing on the exchange or association, or a facility thereof, and, in the case of an exchange, a notice that the exchange has submitted an application under § 240.12d–2 to the Commission to delist a class of the issuer's securities, or, in the case of an association, a notice that the association has taken all necessary steps under it rules to delist the security from its facility; a list of all issuers, using unique identifiers, alleged to not satisfy a rule or standard for continued listing and any action taken with respect to any listed issuer that allegedly failed to satisfy any rule or standard for continued listing; and a list of any issuers, using unique identifiers, that are alleged to have failed to file timely quarterly or annual reports. The summary must set forth the rule or standard for continued listing that the issuer is alleged to have failed to satisfy and the date when the issuer was alleged to have failed to satisfy any rule or standard for continued listing; and the status of any compliance plan for the issuer, including any alleged failure by the issuer to satisfy the requirements of the compliance plan. In addition, for listed options, the report should include a list and a factual description of the circumstances surrounding options classes or series that were improperly listed; and

(viii) Copies of the final agenda of any meeting of the board and of any executive board of the exchange or association, or of any committee of the board or executive board, that occurred during the reporting period.

(3) *Annual report.* In addition to a year-end cumulative presentation of the information specified in paragraph (b)(2)(i) through (b)(2)(vii), and the information specified in paragraph (a)(2), the following information must be filed with the Commission by every national securities exchange and registered securities association as part of the annual report:

(i) A complete discussion of the internal policies and procedures for carrying out the regulatory responsibilities of the exchange or association, including a discussion of the overall program of surveillance and enforcement and any new, revised, or terminated surveillance programs along with a discussion of the reasons for any change. In addition, the exchange or association must submit as part of the annual report a chart indicating by group or section the regulatory activities performed by such group or section, the number of staff involved in each group or section, the names of the staff responsible for such regulatory activities, and the names of the supervisors of each group or section;

(ii) An evaluation of the effectiveness of the exchange's or association's

regulatory programs in effect during the reporting period, including a discussion of the overall operation and effectiveness of the regulatory program; the particular strengths and weaknesses of the regulatory program; areas in which the regulatory program needs to be improved; and any planned revisions to the regulatory program in response to any weaknesses, including those weaknesses uncovered during the process of preparing the annual and quarterly reports required by this section;

(iii) A complete discussion of the internal controls implemented by the exchange or association that are designed to detect, prevent, and control for any conflicts of interest between the market operations and other commercial interests of the exchange or association and its self-regulatory responsibilities, and to assure that the exchange or association appropriately carries out its self-regulatory responsibilities;

(iv) A complete discussion of the exchange's or association's employment arrangements with its Chief Regulatory Officer and other senior regulatory program personnel;

(v) Copies of the most recent annual performance self-evaluation of each standing committee of the board of a national securities exchange or registered securities association, as well as the annual governance performance evaluation prepared by each exchange's or association's Governance Committee, as set forth in § 240.6a–5 and § 240.15Aa–3; and

(vi) A complete discussion of the exchange or association's efforts to comply with any recommendations or plan resulting from any inspection or examination conducted by the Commission's staff.

(c) *Certifications.* The reports provided for in paragraph (a) of this section, as well as any supplement provided for in paragraph (d) of this section, must be accompanied by a certification, executed by an exchange's or association's chief executive officer on behalf of, and with the authority of, the exchange or association, representing that the information contained in the respective report or amendment is current, true, and complete as of the date filed with the Commission.

(d)(1) *Interim changes to the regulatory program.* Any material change to the regulatory program of a national securities exchange or registered securities association, or any material developments that affect such regulatory program, including any changes to the parameters used in surveilling for and enforcing compliance with the federal securities laws and rules and regulations thereunder and the exchange's or association's rules, including any new, revised, or terminated surveillance and enforcement programs that occurred since the filing of the prior quarterly report required by this section, must be reported in a supplemental filing with the Commission within ten business days of such change, along with a discussion of the reasons for such change.

(2) *Interim changes to the regulatory department or unit.* Any material change to the organization or staffing of any regulatory or supervisory department or unit must be reported in a supplemental filing with the Commission within ten business days of such change, along with a discussion of the reasons for such change.

(e) *Confidentiality.* All information submitted pursuant to this section will be accorded confidential treatment to the extent permitted by law.

(f) *Compliance date.* Every national securities exchange and national securities association must comply with this section beginning with the first full quarterly reporting period commencing [six months from the date of publication of the final rule in the **Federal Register**].

(g) *Extensions.* Upon written request or on its own motion, the Commission may grant an extension of time for filing any reports or materials required by this section, if the Commission determines that such extension is necessary or appropriate in the public interest and is consistent with the protection of investors.

(h)(1) *Exemptions.* Upon written request or on its own motion, the Commission may grant an exemption from any of the requirements of this section, either unconditionally or on specified terms and conditions, if the Commission determines that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors.

(2) A national securities exchange registered pursuant to section 6(g) of the Act (15 U.S.C. 78f(g)), and a limited purpose national securities association registered pursuant to section 15A(k)(1) of the Act (15 U.S.C. 78*o*–3(k)(1)) are exempt from the requirements of this section.

(i) Each report filed pursuant to this section shall constitute a ''report'' within the meaning of sections 17(a), 18(a), and 32(a) of the Act (15 U.S.C. 78q(a), 78r(a), and 78ff(a)), and any other applicable provisions of the Act.

(j) *Definitions.* For purposes of this section,

(1) The term *Act* means the Securities Exchange Act of 1934.

(2) The term *board* means the Board of Directors or Board of Governors of a national securities exchange or registered securities association, or any equivalent body.

(3) The term *electronic SRO trading facility* means a facility of an exchange or association that executes orders in securities on an electronic basis.

(4) The term *facility* has the same meaning as set forth in section 3(a)(2) of the Act (15 U.S.C. 78c(a)(2)), or § 240.15Aa–3, as applicable.

(5) The term *regulatory subsidiary* means any person that, directly or indirectly, is controlled by the national securities exchange or registered securities association and that provides, whether pursuant to contract, agreement or rule, regulatory services to or on behalf of the national securities exchange or registered securities association.

(6) The term *standing committee* has the same meaning as defined in § 240.6a–5(b)(21) for a national securities exchange and in § 240.15Aa–3(b)(22) for a registered securities association.

11. Section 240.17a–27 is added to read as follows:

§ 240.17a–27 Ownership of a national securities exchange, registered securities association, or facility of a national securities exchange or registered securities association.

(a) *Definitions.* (1) The term *Act* means the Securities Exchange Act of 1934.

(2) The term *affiliate* means, with respect to any person, any other person that directly or indirectly controls, is controlled by, or is under common control with, the person.

(3) The terms *beneficial ownership, beneficially owns* or any derivative thereof shall have the same meaning, with respect to any security or other ownership interest, as set forth in § 240.13d–3, as if (and whether or not) such security or other ownership interest were a voting equity security registered under section 12 of the Act (15 U.S.C. 78*l*); *provided that* to the extent any person beneficially owns any security or other ownership interest solely because such person is a member of a group within the meaning of section 13(d)(3) of the Act (15 U.S.C. 78m(d)(3)), such person shall not be deemed to beneficially own such security or other ownership interest for purposes of this section, unless such person has the power to direct the vote of such security or other ownership interest.

(4) The term *class of securities of a disclosure entity* means the outstanding

securities of such class, exclusive of any securities of such class held by or for the account of the disclosure entity or a subsidiary of the disclosure entity.

(5) The term *control* means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise. A person is presumed to control another person if the person:

(i) Is a director, general partner or officer exercising executive responsibility (or having similar status or functions);

(ii) Directly or indirectly has the right to vote 25 percent or more of a class of voting securities or has the power to sell or direct the sale of 25 percent or more of a class of voting securities; or

(iii) In the case of a partnership, has the right to receive, upon dissolution, or has contributed, 25 percent or more of the capital.

(6) The term *disclosure entity* means, with respect to a member,

(i) A national securities exchange of which it is a member, other than an exchange registered pursuant to section 6(g) of the Act (15 U.S.C. 78f(g));

(ii) A registered securities association of which it is a member, other than a limited purpose national securities association registered pursuant to section 15A(k)(1) of the Act (15 U.S.C. 78*o*–3(k)(1)); and

(iii) A facility of such national securities exchange or registered securities association through which it is permitted to effect transactions.

(7) The term *facility* shall have the meaning in section 3(a)(2) of the Act (15 U.S.C. 78c(a)(2)) or § 240.15Aa–3, as applicable.

(8) The term *immediate family member* means a person's spouse, parents, children, and siblings, whether by blood, marriage, or adoption, or anyone residing in such person's home.

(9) The term *member* shall have the meaning set forth in section 3(a)(3) of the Act (15 U.S.C. 78c(a)(3)).

(10) The term *national securities exchange* means any exchange registered pursuant to section 6 of the Act (15 U.S.C. 78g).

(11) The term *person* shall have the meaning in section 3(a)(9) of the Act (15 U.S.C. 78c(a)(9)).

(12) The term *registered securities association* means any association of brokers and dealers registered pursuant to section 15A of the Act (15 U.S.C. 78*o*–3).

(13) The term *related person* means, with respect to any member that is a broker or dealer:

(i) Any affiliate of the member;

(ii) Any person associated with the member;

(iii) Any immediate family member of such member, or any immediate family member of the member's spouse, who, in each case, has the same home as the member or who is a director or officer of the disclosure entity or any of its parents or subsidiaries; and

(iv) Any immediate family member of a person associated with the member, or any immediate family member of that person's spouse, who, in each case, has the same home as the person associated with the member or who is a director or officer of the disclosure entity or any of its parents or subsidiaries.

(14) The term *share* means a share of stock in a corporation or unit of interest in an unincorporated person.

(b)(1) *Filing requirement.* A member of a national securities exchange or registered securities association that is a broker or dealer must file with the Commission a statement containing the information required by paragraph (b)(2) of this section if such member, directly or indirectly, alone or together with its related persons, beneficially owns more than five percent of any class of securities or other ownership interest in a disclosure entity.

(2) *Required information.* A statement that a member is required to file under paragraph (b)(1) of this section must include the following:

(i) The title of the class of securities or other ownership interest for which the member is required to file this statement, and the identity and form of organization (*e.g.* LLC) of the disclosure entity;

(ii) If the member is a corporation, general partnership, limited partnership, syndicate or other group of persons, its name, the state or other place of its organization, its principal business, the address of its principal business, and the address of its principal office;

(iii) If the member is a natural person, his or her name, residence or business address, present principal occupation or employment, and the name, principal business and address of any corporation or other organization in which such employment is conducted;

(iv) A description of the securities or other ownership interest that are the subject of the filing, including:

(A) The total number of securities or other ownership interests issued and outstanding in each class or series;

(B) If the securities are publicly traded, the market(s) where they trade;

(C) Any restrictions on ownership, voting, transfers, or other disposition of such securities or other ownership interest; and

(D) Any other material provisions relating to ownership of the disclosure entity;

(v) Whether such disclosure entity is a reporting issuer under section 12 of the Act (15 U.S.C. 78*l*);

(vi)(A) The aggregate number and percentage of shares of a class of securities or other ownership interest in such disclosure entity that are beneficially owned by the member;

(B) The aggregate number of shares or ownership interest as to which the member:

(*1*) Has the sole power to vote or to direct the vote;

(*2*) Has shared power to vote or to direct the vote;

(*3*) Has sole power to dispose or to direct the disposition;

(*4*) Has shared power to dispose or to direct the disposition; and

(C) If any other person is known to have the right to receive or the power to direct the receipt of dividends from, or the proceeds from the sale of, such securities or other ownership interest, a statement to that effect should be included in response to this section and, if such interest relates to more than five percent of the securities or other ownership interest, such person should be identified; provided that, a listing of the shareholders of an investment company registered under the Investment Company Act of 1940 or the beneficiaries of an employee benefit plan, pension fund or endowment fund is not required.

(vii) Separately identify each related person whose ownership in a disclosure entity is included in the calculation of beneficial ownership required to be disclosed by the member pursuant to this paragraph (b) and state the aggregate number and percentage of shares of a class of securities or other ownership interest in such disclosure entity that are beneficially owned by the related person. For each related person identified provide the following information:

(A) Indicate the aggregate number of shares or ownership interest as to which the related person:

(*1*) Has the sole power to vote or to direct the vote;

(*2*) Has shared power to vote or to direct the vote;

(*3*) Has sole power to dispose or to direct the disposition;

(*4*) Has shared power to dispose or to direct the disposition; and

(B) If any other person is known to have the right to receive or the power to direct the receipt of dividend from, or the proceeds from the sale of, such securities or other ownership interest, a statement to that effect should be

included in response to this provision and, if such interest relates to more than five percent of the securities or other ownership interest, such person should be identified; provided that, a listing of the shareholders of an investment company registered under the Investment Company Act of 1940 or the beneficiaries of an employee benefit plan, pension fund or endowment fund is not required;

(viii) For each member and its related persons, indicate whether and how such member, alone or together with its related persons, possesses the power, directly or indirectly, to direct or cause the direction of the management and policies of the disclosure entity, whether through ownership of voting securities, by contract, or otherwise;

(ix) Specifically describe the ability of each member and its related persons, through governance provisions or otherwise, to exercise any influence or control over the regulatory responsibilities of the exchange or association; and

(x) A description of any contracts, arrangements, understandings or relationships (legal or otherwise) among the member and its related persons and between such persons and any other person with respect to any securities or other ownership interest of the disclosure entity, including but not limited to transfer or voting of any of the securities or other ownership interest, finder's fees, joint ventures, loan or option arrangements, put or calls, guarantees of profits, division of profits or loss, or the giving or withholding of proxies. Name the persons with whom such contracts, arrangements, understandings or relationships have been entered into. Include such information for any of the securities or other ownership interest that are pledged or otherwise subject to a contingency the occurrence of which would give another person voting power or investment power over such securities or interest except that disclosure of standard default and similar provisions contained in loan agreements need not be included.

(3) *Timing of initial filing.* A member must file a statement containing the information specified in paragraph (b)(2) of this section within 10 calendar days after becoming subject to such filing requirement under paragraph (b)(1) of this section.

(4) *Periodic update.* A member must file an amendment to the statement required pursuant to paragraph (b)(1) of this section within ten calendar days of any change in the information specified under paragraph (b)(2) of this section, except in the event of an increase or decrease of less than 1 percent of ownership of a class of securities or other ownership interest last reported on the statement filed pursuant to paragraph (b)(1) of this section, or any amendment thereto.

(c) *Copy to exchange or association.* The member shall provide a copy of the statement required by paragraph (b)(1) and amendment required by paragraph (b)(4) of this section to the disclosure entity if the disclosure entity is a national securities exchange or registered securities association, or to the applicable national securities exchange or registered securities association, if the disclosure entity is a facility.

(d) *SRO posting requirements.* A national securities exchange or registered securities association must continuously post any statement received from a member pursuant to paragraph (c) of this section on a publicly-accessible Web site controlled by the exchange or association within ten calendar days of receipt of such statement.

(e) *Other provisions.* (1) Each statement filed pursuant to this section shall constitute a ''report'' within the meaning of sections 17(a), 18(a), and 32(a) of the Act (15 U.S.C. 78q(a), 78r(a), and 78ff(a)), and any other applicable provisions of the Act.

(2) Each statement filed pursuant to this section shall be considered filed upon receipt by the Division of Market Regulation at the Commission's principal office in Washington, DC.

(f) *Exemptions.* Upon written request or on its own motion, the Commission may grant an exemption from the provisions of this section, either unconditionally or on specified terms and conditions, if the Commission determines that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors.

PART 242—REGULATIONS M, ATS, AC, NMS, AL, B and SHO AND CUSTOMER MARGIN REQUIREMENTS FOR SECURITY FUTURES

12. The authority citation for part 242 continues to read as follows:

Authority: 15 U.S.C. 77g, 77q(a), 77s(a), 78b, 78c, 78g(c)(2), 78i(a), 78j, 78k–1(c), 78*l*, 78m, 78n, 78o(b), 78o(c), 78o(g), 78q(a), 78q(b), 78q(h), 78w(a), 78dd–1, 78mm, 80a–23, 80a–29, and 80a–37.

13. The part heading for part 242 is revised as set forth above.

14. Part 242 is amended by adding an undesignated center heading and § 242.800, to read as follows:

Regulation AL—National Securities Exchanges and Registered Securities Associations Listing and Trading Affiliated Securities

§ 242.800 Regulation AL; National securities exchanges and registered securities associations listing and trading affiliated securities.

(a) *Definitions.* For purposes of this section:

(1) The term *Act* means the Securities Exchange Act of 1934.

(2) The term *affiliate* means, with respect to any person, any other person that directly or indirectly controls, is controlled by, or is under common control with, the person.

(3) The term *affiliated issuer* means:

(i) With respect to a national securities exchange, the national securities exchange, an SRO trading facility of the national securities exchange, an affiliate of the national securities exchange, or an affiliate of an SRO trading facility of the national securities exchange, and

(ii) With respect to a registered securities association, the registered securities association, an SRO trading facility of the registered securities association, an affiliate of the registered securities association, or an affiliate of an SRO trading facility of the registered securities association.

(4) The term *affiliated security* means any security issued by an affiliated issuer, except that it shall not include any option exempt from the Securities Act of 1933 under § 230.238 of this chapter and any security futures product exempt from the Securities Act of 1933 under section 3(a)(14) of the Securities Act of 1933 (15 U.S.C. 77c(a)(14)).

(5) The term *control* means the possession, direct or indirect, of the power to direct or cause the direction of the management or policies of a person, whether through ownership of voting securities, by contract, or otherwise. A person is presumed to control another person if the person:

(i) Is a director, general partner or officer exercising executive responsibility (or having similar status or functions);

(ii) Directly or indirectly has the right to vote 25 percent or more of a class of voting securities or has the power to sell or direct the sale of 25 percent or more of a class of voting securities; or

(iii) In the case of a partnership, has the right to receive, upon dissolution, or has contributed, 25 percent or more of the capital.

(6) The term *SRO trading facility* means any facility of a national securities exchange or registered

securities association that executes orders in securities.

(7) The term *facility* shall have the meaning in section 3(a)(2) of the Act (15 U.S.C. 78c(a)(2)) and § 240.15Aa–3 of this chapter.

(8) The term *member* shall have the meaning in section 3(a)(3) of the Act (15 U.S.C. 78c(a)(3)).

(9) The term *regulatory oversight committee* means a committee of the national securities exchange or registered securities association as required by § 240.6a–5(j) or § 240.15Aa–3(j) of this chapter.

(b) *Listing and trading of affiliated securities.* (1) A national securities exchange or registered securities association may not approve for listing an affiliated security unless such exchange's or association's regulatory oversight committee certifies that such security satisfies the exchange's or association's rules for listing.

(2) If an affiliated security is listed on, approved for trading on, or trades pursuant to the rules of, a national securities exchange or registered securities association, the exchange or association must:

(i) File with the Commission not more than 30 calendar days after the end of each calendar quarter a report that:

(A) Summarizes such exchange's or association's monitoring of the affiliated security's compliance with exchange's or association's listing rules, including a statement regarding such affiliated security's compliance with each applicable rule; and

(B) Summarizes such exchange's or association's surveillance of the trading of the affiliated security by the exchange's or association's members;

(ii) File with the Commission not more than 60 calendar days after the end of such exchange's or association's fiscal year a report prepared by a third party analyzing compliance by the affiliated security with the exchange's or association's listing rules;

(iii) Notify the affiliated issuer promptly if the exchange or association alleges that the affiliated security is not in compliance with any applicable listing rule of the exchange or association;

(iv) Within five business days of notifying an affiliated issuer under paragraph (b)(2)(iii) of this section, file a report with the Commission that identifies the date the exchange or association alleged that the affiliated security was not in compliance, the listing rule(s) with which the exchange or association alleged such affiliated security failed to comply, the action the exchange or association proposes to take with respect to such affiliated security, and any other material information conveyed to the affiliated issuer; and

(v) Provide the Commission with a copy of any response from the affiliated issuer regarding the exchange's or association's allegation that its affiliated security failed to comply with exchange or association rules within five business days of receipt of such response.

(c) *Regulatory Oversight Committee approval.* (1) The exchange's or association's regulatory oversight committee must approve the reports required to be filed pursuant to paragraphs (b)(2)(i) and (b)(2)(iv) of this section prior to filing with the Commission.

(2) Within five business days of receipt, the exchange or association must provide to the exchange's or association's regulatory oversight committee a copy of the report prepared by a third party pursuant to paragraph (b)(2)(ii) of this section and any response received from an affiliated issuer that is provided to the Commission pursuant to paragraph (b)(2)(v) of this section.

(d) *Application of rules.* Except as otherwise required by this section:

(1) Any action taken by the national securities exchange or registered securities association with regard to the listing of an affiliated security must be in compliance with the rules of the exchange or association;

(2) The exchange or association must not apply the same listing rules to affiliated securities in a manner that is materially different than the treatment afforded to other securities listed on the exchange or association; and

(3) Any action taken by the exchange or association with regard to trading of an affiliated security by the exchange's or association's members must be in compliance with the rules of the exchange or association and with the federal securities laws, and must not be materially different than action taken with respect to the trading of other securities traded on the exchange or association.

(e) *Other provisions.* (1) Each report filed pursuant to paragraphs (b)(2)(i), (b)(2)(ii), and (b)(2)(iv) of this section shall constitute a ''report'' within the meaning of sections 17(a), 18(a), and 32(a) of the Act (15 U.S.C. 78q(a), 78r(a), and 78ff(a)), and any other applicable provisions of the Act.

(2) Each report or response filed pursuant to this section shall be considered filed upon receipt by the Division of Market Regulation at the Commission's principal office in Washington, DC.

(f) *Exemptions.* Upon written request or on its own motion, the Commission may grant an exemption from the provisions of this section, either unconditionally or on specified terms and conditions, if the Commission determines that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors.

PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934

15. The authority citation for part 249 continues to read in part as follows:

Authority: 5 U.S.C. 78a *et seq.* and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

16. Form 1 (referenced in § 249.1) is revised to read as follows:

Note: The text of Form 1 does not and this amendment will not appear in the Code of Federal Regulations.

BILLING CODE 8010–01–P

Insert OMB Box Information

FORM 1 INSTRUCTIONS

A. GENERAL INSTRUCTIONS

1. Form 1 is the application for registration as a national securities exchange or an exchange exempt from registration pursuant to Section 5 of the Securities Exchange Act of 1934 ("Exchange Act").

2. **UPDATING** - A registered exchange or exchange exempt from registration pursuant to Section 5 of the Exchange Act must file amendments to Form 1 in accordance with Exchange Act Rule 6a-2.

3. **CONTACT EMPLOYEE** - The individual listed on the Execution Page (Page 1) of Form 1 as the contact employee must be authorized to receive all contact information, communications, and mailings, and is responsible for disseminating such information within the applicant's organization.

4. **FORMAT**

   - Attach an Execution Page (Page 1) with original manual signatures.
   - Please type all information.
   - Use only the current version of Form 1 or a reproduction.

5. If the information called for by any Exhibit is available in printed form, the printed material may be filed, provided it does not exceed 8 1/2 X 11 inches in size.

6. If any Exhibit required is inapplicable, a statement to that effect shall be furnished in lieu of such Exhibit.

7. All materials required by Form 1 must be filed with the Commission in paper and also posted on a publicly accessible Internet Web site controlled by the applicant.

8. **WHERE TO FILE AND NUMBER OF COPIES** - Submit one original and two copies of Form 1 to: SEC, Division of Market Regulation, Office of Market Supervision, 450 Fifth Street, NW, Washington, DC 20549.

9. **PAPERWORK REDUCTION ACT DISCLOSURE**

   - Form 1 requires an exchange seeking to register as a national securities exchange or seeking an exemption from registration as a national securities exchange pursuant to Section 5 of the Exchange Act to provide the Securities and Exchange Commission ("SEC" or "Commission") with certain information regarding the operation of the exchange.
   - Form 1 also requires national securities exchanges or exchanges exempt from registration based on limited volume to update certain information on a periodic basis.
   - An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. Sections 3(a)(1), 5, 6(a) and 23(a) authorize the Commission to collect information on this Form 1 from exchanges. See 15 U.S.C. §§78c(a)(1), 78e, 78f(a) and 78w(a).
   - Any member of the public may direct to the Commission any comments concerning the accuracy of the burden estimate on the facing page of Form 1 and any suggestions for reducing this burden.
   - Form 1 is designed to enable the Commission to determine whether an exchange applying for registration is in compliance with the provisions of Sections 6 and 19 of the Exchange Act. Form 1 is also designed to enable the Commission to determine whether a national securities exchange or exchange exempt from registration based on limited volume is operating in compliance with the Exchange Act.
   - It is estimated that an exchange will spend approximately [47] hours completing the initial application on Form 1 pursuant to Exchange Act Rule 6a-1. It is also estimated that each exchange will spend approximately [25] hours to prepare each annual amendment to Form 1 pursuant to Rule 6a-2.
   - It is mandatory that an exchange seeking to operate as a national securities exchange or as an exchange exempt from registration based on limited volume file Form 1 with the Commission. It is also mandatory that national securities exchanges or exchanges exempt from registration based on limited volume file amendments to Form 1 under Rule 6a-2.

FORM 1 INSTRUCTIONS

- No assurance of confidentiality is given by the Commission with respect to the responses made in Form 1. The public has access to the information contained in Form 1.
- This collection of information has been reviewed by the Office of Management and Budget ("OMB") in accordance with the clearance requirements of 44 U.S.C. §3507. The applicable Privacy Act system of records is SEC-2 and the routine uses of the records are set forth at 40 FR 39255 (August 27, 1975) and 41 FR 5318 (February 5, 1976).

FORM 1 INSTRUCTIONS

B. EXPLANATION OF TERMS

APPLICANT - The entity or organization filing an application for registration or an exemption for registration, or amending any such application on this Form 1.

AFFILIATE - Any person that, directly or indirectly, controls, is controlled by, or is under common control with, the applicant.

BENEFICIAL OWNERSHIP – shall have the same meaning, with respect to any security or other ownership interest, as set forth in Rule 13d-3 under the Exchange Act, as if (and whether or not) such security or other ownership interest were a voting equity security registered under Section 12 of the Exchange Act; provided that to the extent any person beneficially owns any security or other ownership interest solely because such person is a member of a group within the meaning of Section 13(d)(3) of the Exchange Act, such person shall not be deemed to beneficially own such security or other ownership interest for purposes of this Form 1, unless such person has the power to direct the vote of such security or other ownership interest.

BOARD - Shall mean the Board of Directors or Board of Governors of the exchange, or any equivalent body.

CONTROL - The possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through ownership of voting securities, by contract, or otherwise. A person is presumed to control another person if the person:

(1) is a director, general partner or officer exercising executive responsibility (or having similar status or functions);
(2) directly or indirectly has the right to vote 25 percent or more of a class of voting securities or has the power to sell or direct the sale of 25 percent or more of a class of voting securities; or
(3) in the case of a partnership, has the right to receive, upon dissolution, or has contributed, 25 percent or more of the capital.

DIRECTOR - Shall mean a member of the Board.

DISCLOSURE ENTITY – Shall mean (1) the applicant and (2) any facility of the applicant.

FACILITY – Shall have the same meaning as in Section 3(a)(2) of the Exchange Act.

IMMEDIATE FAMILY MEMBER – Shall mean a person's spouse, parents, children, and siblings, whether by blood, marriage, or adoption, or anyone residing in such person's home.

MEMBER - Shall have the same meaning as in Section 3(a)(3) of the Exchange Act.

NATIONAL SECURITIES EXCHANGE - Shall mean any exchange registered pursuant to Section 6 of the Exchange Act.

PERSON – Shall have the same meaning as in Section 3(a)(9) of the Exchange Act.

PERSON ASSOCIATED WITH A MEMBER - Shall have the same meaning as in Section 3(a)(21) of the Exchange Act.

REGISTERED PUBLIC ACCOUNTING FIRM – Shall have the same meaning as in Section 2(a)(12) of the Sarbanes-Oxley Act of 2002.

REGULATORY SUBSIDIARY – Shall mean any person that, directly or indirectly, is controlled by the applicant and that provides, whether pursuant to contract, agreement or rule, regulatory services to or on behalf of the applicant.

RELATED PERSON - Shall mean,

(1) with respect to any member of an applicant that is a broker or dealer, any related person as defined in Rule 6a-5 under the Exchange Act; or

(2) with respect to any other person:

(a) any affiliate of the person; and

(b) in the case of a person that is a natural person, any immediate family member of such person, or any immediate family member of such person's spouse, who, in each case, has the same home as such person or who is a director or officer of the Disclosure Entity or any of its parents or subsidiaries.

SHARE – Shall mean a share of stock in a corporation or unit of interest in an unincorporated person.

SRO TRADING FACILITY – Shall mean any facility of a national securities exchange that executes orders in securities.

Form 1 Page 1 Execution Page	**UNITED STATES SECURITIES AND EXCHANGE COMMISSION** **WASHINGTON, D.C. 20549** **APPLICATION FOR, AND AMENDMENTS TO APPLICATION FOR, REGISTRATION AS A NATIONAL SECURITIES EXCHANGE OR EXEMPTION FROM REGISTRATION PURSUANT TO SECTION 5 OF THE EXCHANGE ACT**	Date Filed (MM/DD/YY):	OFFICIAL USE ONLY

WARNING: Failure to keep this form current and to file accurate supplementary information on a timely basis, or the failure to keep accurate books and records or otherwise to comply with the provisions of law applying to the conduct of the applicant would violate the federal securities laws and may result in disciplinary, administrative, or criminal action.

INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS

APPLICATION AMENDMENT

1. State the name of the applicant:

2. Provide the applicant's primary street address (Do not use a P.O. Box):

3. Provide the applicant's mailing address (if different):

4. Provide the applicant's business telephone and facsimile numbers:

Telephone: _____ Facsimile: _____

5. Provide the name, title, and telephone number of a contact employee:

Name: _____ Title: _____ Telephone Number: _____

6. Provide the name and address of counsel for the applicant:

7. Provide the date applicant's fiscal year ends:

8. Indicate legal status of applicant:

_ Corporation _ Sole Proprietorship _ Partnership _ Limited Liability Company _ Other (specify):

If other than a sole proprietor, indicate the date and place where applicant obtained its legal status (e.g. state where incorporated, place where partnership agreement was filed or where applicant entity was formed):

(a) Date (MM/DD/YY): _____ (b) State/Country of formation: _____

(c) Statute under which applicant was organized:

9. Provide the Internet Web site address at which the applicant's Form 1 and amendments, as filed with the Commission, may be viewed:

EXECUTION: The applicant consents that service of any civil action brought by, or notice of any proceeding before, the Securities and Exchange Commission in connection with the applicant's activities may be given by registered or certified mail or confirmed telegram to the applicant's contact employee at the main address, or mailing address if different, given in Items 2 and 3. The undersigned, being first duly sworn, deposes and says that he/she has executed this form on behalf of, and with the authority of, said applicant. The undersigned and applicant represent that the information and statements contained herein, including exhibits, schedules, or other documents attached hereto, and other information filed herewith, all of which are made a part hereof, are current, true, and complete.

Date: _____ _____
(MM/DD/YY) (Name of applicant)

By: _____ _____
(Signature) (Printed Name and Title)

Subscribed and sworn before me this _____ day of _____, _____ by _____
(Month) (Year) (Notary Public)

My Commission expires _____ County of _____ State of _____

This page must always be completed in full with original, manual signature and notarization.

Affix notary stamp or seal where applicable.

Form 1 Page 2	**UNITED STATES SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 APPLICATION FOR, AND AMENDMENTS TO APPLICATION FOR, REGISTRATION AS A NATIONAL SECURITIES EXCHANGE OR EXEMPTION FROM REGISTRATION PURSUANT TO SECTION 5 OF THE EXCHANGE ACT**	OFFICIAL USE	OFFICIAL USE ONLY

DO NOT WRITE BELOW THIS LINE - FOR OFFICIAL USE ONLY

EXHIBITS

File all Exhibits with an application for registration as a national securities exchange or exemption from registration pursuant to Section 5 of the Exchange Act and Rule 6a-1, or with amendments to such application pursuant to Rule 6a-2. For each Exhibit, include the name of the applicant, the date upon which the Exhibit was filed and the date as of which the information is accurate (if different from the date of the filing). If any Exhibit required is inapplicable, a statement to that effect shall be furnished in lieu of such Exhibit. For purposes of Exhibits A, B, C, D, E, F, G, H, and I, the term "applicant" includes any facility that is a separate legal entity and any regulatory subsidiary of the applicant. Therefore, the applicant must file as part of these Exhibits the information specified in these Exhibits with respect to any such facility and regulatory subsidiary of the applicant.

Exhibit A — A copy of the constitution, articles of incorporation or association with all subsequent amendments, and of existing by-laws or corresponding rules or instruments, whatever the name, of the applicant.

Exhibit B — A copy of all written rulings, settled practices having the effect of rules, and interpretations of the Board or any committee of the applicant in respect of any provisions of the constitution, by-laws, rules, or trading practices of the applicant, which are not included in Exhibit A.

Exhibit C — Describe the composition, structure and responsibilities of the Board of the applicant. This description should include:

1. A list of all directors who presently hold or have held their positions during the previous year, indicating the following for each: (a) name; (b) title; (c) dates of commencement and termination of term or position; (d) type of business in which each is primarily engaged; (e) whether the director is an "independent director" as defined in 17 C.F.R. 240.6a-5 and the basis for the affirmative determination that such director is an independent director; and (f) any affiliations or relationships that reasonably could affect the director's independent judgment or decision-making as a director.
2. If the Chairman of the Board ("Chairman") and Chief Executive Officer ("CEO") are the same person, indicate the director that is designated as the lead independent director under 17 CFR 240.6a-5.
3. A discussion of the authority of the Board, including any powers of the Board to delegate its authority to management or any executive board or committee.
4. A discussion of the lines of authority between the Chairman and CEO (or between any lead independent director and the CEO when the CEO is the Chairman).
5. The method established by the Board for interested parties to communicate their concerns regarding any matter within the authority or jurisdiction of a Standing Committee directly to the independent directors, as required by 17 CFR 240.6a-5.

Exhibit D — A list of the officers of the applicant who presently hold or have held their offices or positions during the previous year, indicating the following for each: (a) name; (b) title; (c) dates of commencement and termination of term of office; (d) type of business in which each is primarily engaged (e.g. floor broker, specialist, odd lot dealer, etc.); and (e) responsibilities.

Form 1 Page 3	**UNITED STATES SECURITIES AND EXCHANGE COMMISSION** **WASHINGTON, D.C. 20549** **APPLICATION FOR, AND AMENDMENTS TO APPLICATION FOR, REGISTRATION AS A NATIONAL SECURITIES EXCHANGE OR EXEMPTION FROM REGISTRATION PURSUANT TO SECTION 5 OF THE EXCHANGE ACT**	OFFICIAL USE	OFFICIAL USE ONLY

Exhibit E Describe the composition, structure, and responsibilities of any executive board and each committee of the applicant (including Board committees, non-Board committees, mixed Board and non-Board committees, and executive board committees). Include a chart or charts that illustrate fully the governance structure of the applicant. In addition, for each applicant, provide:

1. A list of members of any executive board and each committee (including Board committees, non-Board committees, mixed Board and non-Board committees, and executive board committees), or persons performing similar functions, who presently hold or have held their offices or positions during the previous year, indicating the following for each: (a) name; (b) title; (c) dates of commencement and termination of term of office or position; (d) type of business in which each is primarily engaged; and (e) any affiliations or relationships that reasonably could affect the executive board or committee member's independent judgment or decision-making.
2. A copy of the written charter for each Standing Committee, as defined in 17 CFR 240.6a-5.

Exhibit F Provide:

1. A copy of the governance guidelines of the applicant.
2. A copy of the code of conduct and ethics for directors, officers, and employees of the applicant.
3. A disclosure of any waivers of the code of conduct and ethics for directors, officers or employees of the applicant.

Exhibit G Provide a chart or charts illustrating fully the internal organizational structure of the applicant. The chart or charts should indicate the internal divisions or departments; the responsibilities of each such division or department; and the reporting structure of each division or department, including its oversight by committees (or their equivalent).

Exhibit H With regard to the regulatory program of the applicant, provide the following information:

1. Describe fully the regulatory program of the applicant, including member firm regulation, market surveillance, enforcement, listing qualifications, arbitration, rulemaking and interpretation, and the process for assessment and development of regulatory policy.
2. Describe the independence of the regulatory program of the applicant from the market operations and other commercial interests of the applicant.
3. Provide a copy of any delegation plan or other contract or agreement relating to regulatory services that are provided or will be provided to the applicant by another self-regulatory organization, a regulatory subsidiary of the applicant, or a regulatory subsidiary of another self-regulatory organization.
4. Discuss any significant changes planned for the regulatory program of the applicant.
5. Discuss fully any new significant regulatory issues that have arisen or any significant events that have taken place, including any technology or trading issues, that relate to or otherwise may affect the applicant's regulatory responsibilities or the operation of its regulatory program, and discuss the effect these significant issues or events may have on the mission, strategy, and future operations of the applicant's regulatory program.

Form 1 Page 4	**UNITED STATES SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 APPLICATION FOR, AND AMENDMENTS TO APPLICATION FOR, REGISTRATION AS A NATIONAL SECURITIES EXCHANGE OR EXEMPTION FROM REGISTRATION PURSUANT TO SECTION 5 OF THE EXCHANGE ACT**	OFFICIAL USE	OFFICIAL USE ONLY

Exhibit I

For the latest fiscal year, audited financial statements of the applicant that are prepared in accordance with, or in the case of a foreign applicant, reconciled with, United States generally accepted accounting principles, and are covered by a report prepared by a registered public accounting firm. In addition to the foregoing, for the applicant, provide the following information:

1. Financial information regarding the applicant, including a comparison to the same figures for the prior fiscal year and estimated figures for the next fiscal year, as follows:

    a. The percentage of the applicant's total annual budget devoted to regulatory activities, in the aggregate and itemized by program area, including supervision of members, surveillance activities, and disciplinary activities;
    b. The percentage of the applicant's total annual revenues devoted to regulatory activities, in the aggregate and itemized by program area, including supervision of members, surveillance activities, and disciplinary activities;
    c. The total dollar amount of the applicant's annual revenues and expenses, in the aggregate and itemized by program area, itemized on the basis of the following categories and sub-categories, and any other categories that incorporate the applicant's revenues and expenses, with each category annotated as appropriate to further a clear understanding of the nature of the revenues and expenses reported;
        i. Revenues, including:
            A. Regulatory fees, including member dues and assessments and similar fees, for the purpose of funding regulation, itemized by category;
            B. Other member dues and assessments not included in subparagraph 1.c.i.A. above;
            C. Transaction fees, transaction services fees, trading privileges fees, and similar fees, itemized by category;
            D. Market information fees, including market data fees, itemized by product;
            E. Fines and penalties resulting from disciplinary and enforcement actions;
            F. Fees paid by issuers, including listing fees and issuer services;
            G. Investments, including dividend and interest income;
            H. Other revenues, itemized as appropriate.
        ii. Direct expenses incurred for the applicant's regulatory activities, including supervision of members, surveillance activities, and disciplinary activities not included in allocated costs reported under subparagraph 1.c.iii. below, including, but not limited to:
            A. Personnel expenses, including compensation expenses;
            B. Compensation schedules for the Chief Regulatory Officer and all other senior regulatory personnel, including bonus ranges;
            C. Training;
            D. Expenses incurred in connection with examinations, investigations, and enforcement actions, reported separately;
            E. Information technology expenses, itemized by categories including data center costs, systems hardware and software, systems consultant fees, and electronic surveillance systems;
            F. Costs associated with any contract or other agreement with a regulatory subsidiary or another self-regulatory organization that provides (whether pursuant to contract, agreement, or rule) regulatory services to or on behalf of the applicant, disclosed separately;

Form 1 Page 5	**UNITED STATES SECURITIES AND EXCHANGE COMMISSION** **WASHINGTON, D.C. 20549** **APPLICATION FOR, AND AMENDMENTS TO APPLICATION FOR, REGISTRATION AS A NATIONAL SECURITIES EXCHANGE OR EXEMPTION FROM REGISTRATION PURSUANT TO SECTION 5 OF THE EXCHANGE ACT**	OFFICIAL USE	OFFICIAL USE ONLY

G. Occupancy and other overhead expenses;
H. Professional services, including auditing;
I. Depreciation and amortization; and
J. Other expenses. itemized as appropriate.

iii. Allocated expenses incurred by non-regulatory personnel attributable to regulation-related activities of other divisions and offices or personnel of other divisions and offices that are not formally a part of the exchange or exchange's regulatory program, including, but not limited to:

A. Personnel expenses, based on a stated percentage of employee hours devoted to regulation-related activities;
B. Information technology expenses;
C. Occupancy and other overhead expenses; and
D. Other allocated costs including, but not limited to legal fees related to regulatory activities and expenses of regulatory and business conduct committees.

2. An itemization of non-regulatory expenses, including, but not limited to, personnel expenses, program expenses, systems and other technology expenses, consultants and advisors, and overhead.
3. A discussion of information necessary to an understanding of the financial condition of the applicant and any material changes in its financial condition.
4. A discussion of any unusual or infrequent events or transactions or any significant economic changes that have had a material effect on the financial condition of the applicant and any known demands, commitments, events or uncertainties that would result in or are reasonably likely to result in a material change in financial condition. The discussion should focus on material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future financial condition.
5. A description of any significant business development involving the applicant, including reorganization, merger or consolidation, acquisition or disposition of significant assets, or any other material change in the business or operations of the applicant.
6. A description of all material contracts and all material related party transactions. In this context, "material" contracts and related party transactions are those to which the applicant or any facility or regulatory subsidiary of the applicant is a party; any director, nominee for director, officer, member, lessee, or any immediate family member of any of the foregoing is also a party; and either the amount involved exceeds $60,000 or it is not a contract made in the ordinary course of business of the applicant or any facility or regulatory subsidiary of the applicant.
7. A description of material commitments by the applicant for expenditures as of the end of the latest fiscal period, and indicate the general purpose of such commitments and the anticipated source of funds needed to fulfill such commitments.
8. Any charitable contributions of the applicant in excess of $1,000, whether made directly or indirectly, to a charity in which an executive officer or director of the applicant, or any of their immediate family members, is an executive officer or director of the charity.
9. A table detailing the compensation of the five most highly compensated executives of the applicant, which table shall be modeled after the compensation table required to be disclosed by public reporting companies in Item 402(b) of Regulation S-K.

Form 1 Page 6	**UNITED STATES SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 APPLICATION FOR, AND AMENDMENTS TO APPLICATION FOR, REGISTRATION AS A NATIONAL SECURITIES EXCHANGE OR EXEMPTION FROM REGISTRATION PURSUANT TO SECTION 5 OF THE EXCHANGE ACT**	OFFICIAL USE	OFFICIAL USE ONLY

10. A description of the material terms of the employment agreements of the five most highly compensated executives of the applicant.
11. A description of the compensation provided to directors.

Exhibit J

For each affiliate of the applicant (unless the information has been provided pursuant to Exhibit I), provide separate financial statements for the latest fiscal year. Such financial statements shall consist, at a minimum, of a balance sheet and an income statement and a statement of cash flows with such footnotes and other disclosures as are necessary to avoid rendering the financial statements misleading. If any affiliate is required by another Commission rule to submit annual financial statements, a statement to that effect, with a citation to the other Commission rule, may be provided along with a copy of the financial statements prepared pursuant to such other Commission rule.

Exhibit K

For each affiliate of the applicant and for any unaffiliated entity that operates an SRO trading facility, provide the following information (unless the information has been provided pursuant to another Exhibit to this form):

1. Name and address of organization.
2. Form of organization (e.g., association, corporation, partnership, etc.).
3. Name of state and statute citation under which organized. Date of incorporation in present form.
4. Brief description of nature and extent of affiliation.
5. Brief description of business or functions. Description should include responsibilities with respect to operation of the SRO trading facility and/or execution, reporting, clearance, or settlement of transactions in connection with operation of the SRO trading facility.

In addition to the foregoing, for each affiliate of the applicant and for any unaffiliated entity that operates an SRO trading facility, provide the following information (unless the information has been provided pursuant to another Exhibit to this form):

1. A copy of the constitution.
2. A copy of the articles of incorporation or association, including all amendments.
3. A copy of existing by-laws or corresponding rules or instruments.
4. The name and title of the present officers, governors, members of all standing committees, or persons performing similar functions.
5. An indication of whether such business or organization ceased to be associated with the applicant during the previous year, and a brief statement of the reasons for termination of the association.

Form 1 Page 7	**UNITED STATES SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 APPLICATION FOR, AND AMENDMENTS TO APPLICATION FOR, REGISTRATION AS A NATIONAL SECURITIES EXCHANGE OR EXEMPTION FROM REGISTRATION PURSUANT TO SECTION 5 OF THE EXCHANGE ACT**	OFFICIAL USE	OFFICIAL USE ONLY

Exhibit L Describe the manner of operation of any SRO trading facility. This description should include the following:

1. The means of access to the SRO trading facility.
2. Procedures governing entry and display of quotations and orders in the SRO trading facility.
3. Procedures governing the execution, reporting, clearance and settlement of transactions in connection with the SRO trading facility.
4. Proposed fees.
5. Procedures for ensuring compliance with SRO trading facility usage guidelines.
6. The hours of operation of the SRO trading facility, and the date on which applicant intends to commence operation of the SRO trading facility.
7. Attach a copy of the users' manual.
8. If the applicant proposes to hold funds or securities on a regular basis, describe the controls that will be implemented to ensure safety of those funds or securities.

Exhibit M A complete set of all forms pertaining to:

1. Application for membership, participation, or subscription to the applicant.
2. Application for approval as a person associated with a member, participant, or subscriber of the applicant.
3. Any other similar materials.

Exhibit N A complete set of all forms of financial statements, reports, or questionnaires required of members, participants, subscribers, or any other users relating to financial responsibility or minimum capital requirements for such members, participants, or any other users. Provide a table of contents listing the forms included in this Exhibit N.

Exhibit O A complete set of documents comprising the applicant's listing applications, including any agreements required to be executed in connection with listing and a schedule of listing fees. If the applicant does not list securities, provide a brief description of the criteria used to determine what securities may be traded on the exchange. Provide a table of contents listing the forms included in this Exhibit O.

Exhibit P Provide an organizational chart showing the relationship between and among the applicant, any facility of the applicant, and any affiliate(s) of the applicant or a facility of the applicant. In addition, provide the following information for the applicant and each facility and affiliate:

1. Full legal name.
2. The form of organization (e.g., corporation, limited liability company) and the jurisdiction and statute citation under which the applicant, the facility or the affiliate is organized.
3. Ownership structure.
4. Whether the applicant, facility or affiliate is a reporting issuer under Section 12 of the Exchange Act.
5. Whether the applicant, facility or affiliate is registered with the Commission as a broker or dealer, investment adviser, or otherwise.
6. Whether and how a facility or affiliate possesses the power, directly or indirectly, to direct or cause the direction of the management and policies of the applicant, whether through ownership of voting securities, by contract, or otherwise.
7. Specifically describe the ability of the facility or affiliate, through governance provisions or otherwise, to exercise any influence or control over the applicant's regulatory responsibilities.

Form 1 Page 8	**UNITED STATES SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 APPLICATION FOR, AND AMENDMENTS TO APPLICATION FOR, REGISTRATION AS A NATIONAL SECURITIES EXCHANGE OR EXEMPTION FROM REGISTRATION PURSUANT TO SECTION 5 OF THE EXCHANGE ACT**	OFFICIAL USE	OFFICIAL USE ONLY

Exhibit Q Provide the following information:

1. A description of each class or series of outstanding securities or other ownership interest (including debt) of each Disclosure Entity that includes:
   a. The title of the class of securities or other ownership interest;
   b. The total number of securities or other ownership interest issued and outstanding;
   c. Any restrictions on ownership, voting, transfers, or other disposition of such securities or other ownership interest;
   d. If the securities are publicly traded, the market(s) where they trade; and
   e. Any other material information relating to ownership of the Disclosure Entity.
2. Provide the following information with regard to any person, alone or together with its Related Persons, that directly or indirectly beneficially owns more than 5% of any class of securities or other ownership interest in a Disclosure Entity:
   a. If the person is a corporation, general partnership, limited partnership, syndicate or other group of persons, provide the following information:
      i. Name;
      ii. The state or other place of its organization;
      iii. Its principal business;
      iv. The address of its principal business; and
      v. The address of its principal office.
   b. If the person is a natural person, provide the following information:
      i. Name;
      ii. Residence or business address; and
      iii. Present principal occupation or employment and the name, principal business and address of any corporation or other organization in which such employment is conducted.
      iv. Whether such person is an officer or director of the Disclosure Entity.
   c. For each person, state the aggregate number and percentage of the shares of a class of securities or other ownership interest that are beneficially owned. In addition:
      i. Indicate the aggregate number of shares or ownership interest as to which there is sole power to vote or to direct the vote, shared power to vote or to direct the vote, sole power to dispose or to direct the disposition, or shared power to dispose or to direct the disposition.
      ii. If any other person is known to have the right to receive or the power to direct the receipt of dividends from, or the proceeds from the sale of, such securities or other ownership interest, a statement to that effect should be included in response to this provision and, if such interest relates to more than 5% of the securities or other ownership interest, such person should be identified. A listing of the shareholders of an investment company registered under the Investment Company Act of 1940 or the beneficiaries of an employee benefit plan, pension fund or endowment fund is not required.

Form 1 Page 9	**UNITED STATES SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 APPLICATION FOR, AND AMENDMENTS TO APPLICATION FOR, REGISTRATION AS A NATIONAL SECURITIES EXCHANGE OR EXEMPTION FROM REGISTRATION PURSUANT TO SECTION 5 OF THE EXCHANGE ACT**	OFFICIAL USE	OFFICIAL USE ONLY

3. Separately identify each Related Person whose ownership in a Disclosure Entity is included in the calculation of beneficial ownership required to be disclosed pursuant to Paragraph 2 of this Exhibit Q, and state the aggregate number and percentage of shares of a class of securities or ownership interest that are beneficially owned. In addition:
    a. Indicate the aggregate number of shares or ownership interest as to which there is sole power to vote or to direct the vote, shared power to vote or to direct the vote, sole power to dispose or to direct the disposition, or shared power to dispose or to direct the disposition.
    b. If any other person is known to have the right to receive or the power to direct the receipt of dividends from, or the proceeds from the sale of, such securities or other ownership interest, a statement to that effect should be included in response to this provision and, if such interest relates to more than 5% of the securities or other ownership interest, such person should be identified. A listing of the shareholders of an investment company registered under the Investment Company Act of 1940 or the beneficiaries of an employee benefit plan, pension fund or endowment fund is not required.
    c. Indicate whether the Related Person is an officer or director of the Disclosure Entity.
4. In determining, for purposes of this Exhibit Q, any percentage of a class of any security of a Disclosure Entity, such class shall be deemed to consist of the outstanding securities of such class, exclusive of any securities of such class held by or for the account of the Disclosure Entity or a subsidiary of the Disclosure Entity.
5. For each person and its Related Person, state whether and how such person, alone or with its Related Persons, possesses the power, directly or indirectly, to direct or cause the direction of the management or policies of the Disclosure Entity, whether through ownership of voting securities, by contract, or otherwise.
6. If the Disclosure Entity is a partnership, provide a list of all general partners and those limited and special partners that have the right to receive upon dissolution, or have contributed, more than 5% of the partnership's capital.
7. Describe any contracts, arrangements, understandings or relationships (legal or otherwise) among the persons identified in Paragraphs 2.a, 2.b, and 3 of this Exhibit Q and between such persons and any other person with respect to any securities or other ownership interest of the Disclosure Entity, including but not limited to transfer or voting of any of the securities or other ownership interest, finder's fees, joint ventures, loan or option arrangements, put or calls, guarantees of profits, division of profits or loss, or the giving or withholding of proxies, and name the persons with whom such contracts, arrangements, understandings or relationships have been entered into. Include such information for any of the securities or other ownership interest that are pledged or otherwise subject to a contingency, the occurrence of which would give another person voting power or investment power over such securities or other ownership interest, except that disclosure of standard default and similar provisions contained in loan agreements need not be included.

Form 1 Page 10	UNITED STATES SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 APPLICATION FOR, AND AMENDMENTS TO APPLICATION FOR, REGISTRATION AS A NATIONAL SECURITIES EXCHANGE OR EXEMPTION FROM REGISTRATION PURSUANT TO SECTION 5 OF THE EXCHANGE ACT	OFFICIAL USE	OFFICIAL USE ONLY

Exhibit R Describe the applicant's criteria for membership. Describe conditions under which members may be subject to suspension or termination with regard to access to the exchange. Describe any procedures that will be involved in the suspension or termination of a member.

Exhibit S Provide an alphabetical list of all members, participants, subscribers or other users, including the following information:

1. Name;
2. Date of election to membership or acceptance as a participant, subscriber or other user;
3. Principal business address and telephone number;
4. If member, participant, subscriber or other user is an individual, the name of the entity with which such individual is associated and the relationship of such individual to the entity (e.g., partner, officer, director, employee, etc.);
5. Describe the type of activities primarily engaged in by the member, participant, subscriber, or other user (e.g., floor broker, specialist, odd lot dealer, other market maker, proprietary trader, non-broker dealer, inactive or other functions). A person shall be "primarily engaged" in an activity or function for purposes of this item when that activity or function is the one in which that person is engaged for the majority of their time. When more than one type of person at an entity engages in any of the six types of activities or functions enumerated in this item, identify each type (e.g., proprietary trader, Registered Competitive Trader and Registered Competitive Market Maker) and state the number of members, participants, subscribers, or other users in each; and
6. The class of membership, participation or subscription or other access.

Exhibit T Provide a schedule for each of the following:

1. The securities listed on the applicant or any facility of the applicant, indicating for each the name of the issuer and a description of the security;
2. The securities admitted to unlisted trading privileges, indicating for each the name of the issuer and a description of the security;
3. The unregistered securities admitted to trading on the applicant or any facility of the applicant that are exempt from registration under Section 12(a) of the Act. For each security listed, provide the name of the issuer and a description of the security, and the statutory exemption claimed (e.g., 17 CFR 240.12a-6); and
4. Other securities traded on the applicant or any facility of the applicant, including for each the name of the issuer and a description of the security.
5. If a class of securities of the applicant, an SRO trading facility of the applicant, or any affiliate of the applicant or an SRO trading facility of the applicant, is listed on, approved for trading on, or trades pursuant to the rules of, the applicant, an explanation of the process for monitoring initial and ongoing compliance by the security with the applicant's listing rules and trading in the security by the applicant's members, as well as the process for enforcing the applicant's listing rules, trading rules and federal securities laws with respect to the listing and trading of the securities.

Exhibit U Provide the name and address for the location of the applicant's books and records.

17. Section 249.2 and Form 2 (referenced in § 249.2) are added to read as follows:

§ 249.2 Form 2, for application for, and amendments to applications for, registration as a registered securities association or affiliated securities association.

The form shall be used for application for, and amendments to applications for, registration as a registered securities association or affiliated securities association.

Note: The text of Form 2 does not and this amendment will not appear in the Code of Federal Regulations.

Insert OMB Box Information

FORM 2 INSTRUCTIONS

A. GENERAL INSTRUCTIONS

1. Form 2 is the application for registration as a registered securities association or an affiliated securities association pursuant to Section 15A of the Securities Exchange Act of 1934 ("Exchange Act").

2. **UPDATING** - A registered securities association or affiliated securities association must file amendments to Form 2 in accordance with Exchange Act Rule 15Aa-2.

3. **CONTACT EMPLOYEE** - The individual listed on the Execution Page (Page 1) of Form 2 as the contact employee must be authorized to receive all contact information, communications, and mailings, and is responsible for disseminating such information within the applicant's organization.

4. **FORMAT**

- Attach an Execution Page (Page 1) with original manual signatures.
- Please type all information.
- Use only the current version of Form 2 or a reproduction.

5. If the information called for by any Exhibit is available in printed form, the printed material may be filed, provided it does not exceed 8 1/2 X 11 inches in size.

6. If any Exhibit required is inapplicable, a statement to that effect shall be furnished in lieu of such Exhibit.

7. All materials required by Form 2 must be filed with the Commission in paper and also posted on a publicly accessible Internet Web site controlled by the applicant.

8. **WHERE TO FILE AND NUMBER OF COPIES** - Submit one original and two copies of Form 2 to: SEC, Division of Market Regulation, Office of Market Supervision, 450 Fifth Street, NW, Washington, DC 20549.

9. **PAPERWORK REDUCTION ACT DISCLOSURE**

- Form 2 requires an association seeking to register as a registered securities association or affiliated securities association to provide the Securities and Exchange Commission ("SEC" or "Commission") with certain information regarding the operation of the association.
- Form 2 also requires registered securities associations or affiliated securities associations to update certain information on a periodic basis.
- An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. Sections 3(a)(26), 15A, and 23(a) authorize the Commission to collect information on this Form 2 from associations. See 15 U.S.C. §§78c(a)(26), 78o-3, and 78w(a).
- Any member of the public may direct to the Commission any comments concerning the accuracy of the burden estimate on the facing page of Form 2 and any suggestions for reducing this burden.
- Form 2 is designed to enable the Commission to determine whether an association applying for registration is in compliance with the provisions of Sections 15A and 19 of the Exchange Act. Form 2 is also designed to enable the Commission to determine whether a registered securities associations or affiliated securities association is operating in compliance with the Exchange Act.
- It is estimated that an exchange will spend approximately [47] hours completing the initial application on Form 2 pursuant to Exchange Act Rule 15Aa-2. It is also estimated that each exchange will spend approximately [25] hours to prepare each annual amendment to Form 2 pursuant to Rule 15Aa-2.
- It is mandatory that an association seeking to operate as a registered securities association or as an affiliated securities association file Form 2 with the Commission. It is also mandatory that registered securities associations or affiliated securities associations file amendments to Form 2 under Rule 15Aa-2.

FORM 2 INSTRUCTIONS

- No assurance of confidentiality is given by the Commission with respect to the responses made in Form 2. The public has access to the information contained in Form 2.
- This collection of information has been reviewed by the Office of Management and Budget ("OMB") in accordance with the clearance requirements of 44 U.S.C. §3507. The applicable Privacy Act system of records is SEC-2 and the routine uses of the records are set forth at 40 FR 39255 (August 27, 1975) and 41 FR 5318 (February 5, 1976).

FORM 2 INSTRUCTIONS

B. EXPLANATION OF TERMS

APPLICANT - The entity or organization filing an application for registration or an exemption for registration, or amending any such application on this Form 2.

AFFILIATE - Any person that, directly or indirectly, controls, is controlled by, or is under common control with, the applicant.

AFFILIATED SECURITIES ASSOCIATION - Shall mean any association registered pursuant to Section 15A(d) of the Exchange Act.

BENEFICIAL OWNERSHIP – shall have the same meaning, with respect to any security or other ownership interest, as set forth in Rule 13d-3 under the Exchange Act, as if (and whether or not) such security or other ownership interest were a voting equity security registered under Section 12 of the Exchange Act; provided that to the extent any person beneficially owns any security or other ownership interest solely because such person is a member of a group within the meaning of Section 13(d)(3) of the Exchange Act, such person shall not be deemed to beneficially own such security or other ownership interest for purposes of this Form 2, unless such person has the power to direct the vote of such security or other ownership interest.

BOARD - Shall mean the Board of Directors or Board of Governors of the association, or any equivalent body.

CONTROL - The possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through ownership of voting securities, by contract, or otherwise. A person is presumed to control another person if the person:

(1) is a director, general partner or officer exercising executive responsibility (or having similar status or functions);

(2) directly or indirectly has the right to vote 25 percent or more of a class of voting securities or has the power to sell or direct the sale of 25 percent or more of a class of voting securities; or

(3) in the case of a partnership, has the right to receive, upon dissolution, or has contributed, 25 percent or more of the capital, is presumed to control that person.

DIRECTOR - Shall mean a member of the Board.

DISCLOSURE ENTITY – Shall mean (1) the applicant and (2) any facility of the applicant.

FACILITY – Shall have the same meaning in 17 CFR 240.15Aa-3.

IMMEDIATE FAMILY MEMBER – Shall mean a person's spouse, parents, children, and siblings, whether by blood, marriage, or adoption, or anyone residing in such person's home.

MEMBER - Shall have the same meaning as in Section 3(a)(3) of the Exchange Act.

REGISTERED SECURITIES ASSOCIATION- Shall mean any association registered pursuant to Section 15A(b) of the Exchange Act.

PERSON – Shall have the same meaning as in Section 3(a)(9) of the Exchange Act.

PERSON ASSOCIATED WITH A MEMBER - Shall have the same meaning as in Section 3(a)(21) of the Exchange Act.

REGISTERED PUBLIC ACCOUNTING FIRM – Shall have the same meaning as in Section 2(a)(12) of the Sarbanes-Oxley Act of 2002.

REGULATORY SUBSIDIARY – Shall mean any person that, directly or indirectly, is controlled by the applicant and that provides, whether pursuant to contract, agreement or rule, regulatory services to or on behalf of the applicant.

RELATED PERSONS - Shall mean,

(1) with respect to any member of an applicant, any related person as defined in Rule 15Aa-3 under the Exchange Act; or

(2) with respect to any other person:

(a) any affiliate of the person; and

(b) in the case of a person that is a natural person, any immediate family member of such person, or any immediate family member of such person's spouse who, in each case, has the same home as such person or who is a director or officer of the Disclosure Entity or any of its parents or subsidiaries.

SHARE – Shall mean a share of stock in a corporation or unit of interest in an unincorporated person.

SRO TRADING FACILITY – Shall mean any facility of a registered securities association that executes orders in securities.

Form 2 Page 1 Execution Page	**UNITED STATES SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 APPLICATION FOR, AND AMENDMENTS TO APPLICATION FOR, REGISTRATION AS A REGISTERED SECURITIES ASSOCIATION OR AFFILIATED SECURITIES ASSOCIATION**	Date Filed (MM/DD/YY):	OFFICIAL USE ONLY

WARNING: Failure to keep this form current and to file accurate supplementary information on a timely basis, or the failure to keep accurate books and records or otherwise to comply with the provisions of law applying to the conduct of the applicant would violate the federal securities laws and may result in disciplinary, administrative, or criminal action.

INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS

APPLICATION AMENDMENT

1. State the name of the applicant:

2. Provide the applicant's primary street address (Do not use a P.O. Box) for (a) statutory office; (b) principal executive office; and (c) branch or district offices:
3. Provide the applicant's mailing address (if different):
4. Provide the applicant's business telephone and facsimile numbers:

   Telephone: _____ Facsimile: _____
5. Provide the name, title, and telephone number of a contact employee:
   Name: _____ Title: _____ Telephone Number: _____
6. Provide the name and address of counsel for the applicant:
7. Provide the date applicant's fiscal year ends:
8. Indicate legal status of applicant:
   _ Corporation _ Sole Proprietorship _ Partnership _ Limited Liability Company _ Other (specify):
   If other than a sole proprietor, indicate the date and place where applicant obtained its legal status (e.g. state where incorporated, place where partnership agreement was filed or where applicant entity was formed):
   (a) Date (MM/DD/YY): _____ (b) State/Country of formation: _____
   (c) Statute under which applicant was organized:
9. Provide the Internet Web site address at which the applicant's Form 2 and amendments, as filed with the Commission, may be viewed:
10. If the application is for registration as an affiliated securities association, provide the name of the registered securities association to which the applicant seeks to be affiliated, and estimate the annual dollar volume of transactions effected by members of the applicant association.

EXECUTION: The applicant consents that service of any civil action brought by, or notice of any proceeding before, the Securities and Exchange Commission in connection with the applicant's activities may be given by registered or certified mail or confirmed telegram to the applicant's contact employee at the main address, or mailing address if different, given in Items 2 and 3. The undersigned, being first duly sworn, deposes and says that he/she has executed this form on behalf of, and with the authority of, said applicant. The undersigned and applicant represent that the information and statements contained herein, including exhibits, schedules, or other documents attached hereto, and other information filed herewith, all of which are made a part hereof, are current, true, and complete.

Date: _____ _____
(MM/DD/YY) (Name of applicant)

By: _____ _____
(Signature) (Printed Name and Title)

Subscribed and sworn before me this _____ day of _____, _____ by _____
(Month) (Year) (Notary Public)

My Commission expires _____ County of _____ State of _____

This page must always be completed in full with original, manual signature and notarization.

Affix notary stamp or seal where applicable.

Form 2 Page 2	**UNITED STATES SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 APPLICATION FOR, AND AMENDMENTS TO APPLICATION FOR, REGISTRATION AS A REGISTERED SECURITIES ASSOCIATION OR AFFILIATED SECURITIES ASSOCIATION**	OFFICIAL USE	OFFICIAL USE ONLY

DO NOT WRITE BELOW THIS LINE - FOR OFFICIAL USE ONLY

EXHIBITS

File all Exhibits with an application for registration as a registered securities association or affiliated securities association, or with amendments to such application pursuant to Rule 15Aa-2. For each Exhibit, include the name of the applicant, the date upon which the Exhibit was filed and the date as of which the information is accurate (if different from the date of the filing). If any Exhibit required is inapplicable, a statement to that effect shall be furnished in lieu of such Exhibit. For purposes of Exhibits A, B, C, D, E, F, G, H, and I, the term "applicant" includes any facility that is a separate legal entity and any regulatory subsidiary of the applicant. Therefore, the applicant must file as part of these Exhibits the information specified in these Exhibits with respect to any such facility and regulatory subsidiary of the applicant.

Exhibit A — A copy of the constitution, articles of incorporation or association with all subsequent amendments, and of existing by-laws or corresponding rules or instruments, whatever the name, of the applicant.

Exhibit B — A copy of all written rulings, settled practices having the effect of rules, and interpretations of the Board or any committee of the applicant in respect of any provisions of the constitution, by-laws, rules, or trading practices of the applicant, which are not included in Exhibit A.

Exhibit C — Describe the composition, structure and responsibilities of the Board of the applicant. This description should include:

1. A list of all directors who presently hold or have held their positions during the previous year, indicating the following for each: (a) name; (b) title; (c) dates of commencement and termination of term or position; (d) type of business in which each is primarily engaged; (e) whether the director is an "independent director" as defined in 17 C.F.R. 240.15Aa-3 and the basis for the affirmative determination that such director is an independent director; and (f) any affiliations or relationships that reasonably could affect the director's independent judgment or decision-making as a director.
2. If the Chairman of the Board ("Chairman") and Chief Executive Officer ("CEO") are the same person, indicate the director that is designated as the lead independent director.
3. A discussion of the authority of the Board, including any powers of the Board to delegate its authority to management or any executive board or committee.
4. A discussion of the lines of authority between the Chairman and CEO (or between any lead independent director and the CEO when the CEO is the Chairman).
5. The method established by the Board for interested parties to communicate their concerns regarding any matter within the authority or jurisdiction of a Standing Committee directly to the independent directors, as required by 17 CFR 15Aa-3.

Exhibit D — A list of the officers of the applicant who presently hold or have held their offices or positions during the previous year, indicating the following for each: (a) name; (b) title; (c) dates of commencement and termination of term of office; (d) type of business in which each is primarily engaged (e.g. floor broker, specialist, odd lot dealer, etc.) and (e) responsibilities.

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Exhibit E Describe the composition, structure, and responsibilities of any executive board and each committee of the applicant (including Board committees, non-Board committees, mixed Board and non-Board committees, and executive board committees). Include a chart or charts that illustrate fully the governance structure of the applicant. In addition, for each applicant, provide:

1. A list of members of any executive board and each committee (including Board committees, non-Board committees, mixed Board and non-Board committees, and executive board committees), or persons performing similar functions, who presently hold or have held their offices or positions during the previous year, indicating the following for each: (a) name; (b) title; (c) dates of commencement and termination of term of office or position; (d) type of business in which each is primarily engaged; and (e) any affiliations or relationships that reasonably could affect the executive board or committee member's independent judgment or decision-making.
2. A copy of the written charter for each Standing Committee, as defined in 17 CFR 240.15Aa-3.

Exhibit F Provide:

1. A copy of the governance guidelines of the applicant.
2. A copy of the code of conduct and ethics for directors, officers, and employees of the applicant.
3. A disclosure of any waivers of the code of conduct and ethics for directors, officers or employees of the applicant.

Exhibit G Provide a chart or charts illustrating fully the internal organizational structure of the applicant. The chart or charts should indicate the internal divisions or departments; the responsibilities of each such division or department; and the reporting structure of each division or department, including its oversight by committees (or their equivalent).

Exhibit H With regard to the regulatory program of the applicant, provide the following information:

1. Describe fully the regulatory program of the applicant, including member firm regulation, market surveillance, enforcement, listing qualifications, arbitration, rulemaking and interpretation, and the process for assessment and development of regulatory policy.
2. Describe the independence of the regulatory program of the applicant from the market operations and other commercial interests of the applicant.
3. Provide a copy of any delegation plan or other contract or agreement relating to regulatory services that are provided or will be provided to the applicant by another self-regulatory organization, a regulatory subsidiary, or a regulatory subsidiary of another self-regulatory organization.
4. Discuss any significant changes planned for the regulatory program of the applicant.
5. Discuss fully any new significant regulatory issues that have arisen or any significant events that have taken place, including any technology or trading issues, that relate to or otherwise may affect the applicant's regulatory responsibilities or the operation of its regulatory program, and discuss the effect these significant issues or events may have on the mission, strategy, and future operations of the applicant's regulatory program.

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Exhibit I For the latest fiscal year, audited financial statements of the applicant that are prepared in accordance with, or in the case of a foreign applicant, reconciled with, United States generally accepted accounting principles, and are covered by a report prepared by a registered public accounting firm. In addition to the foregoing, for the applicant, provide the following information:

1. Financial information regarding the applicant, including a comparison to the same figures for the prior fiscal year and estimated figures for the next fiscal year, as follows:

    a. The percentage of the applicant's total annual budget devoted to regulatory activities, in the aggregate and itemized by program area, including supervision of members, surveillance activities, and disciplinary activities;
    b. The percentage of the applicant's total annual revenues devoted to regulatory activities, in the aggregate and itemized by program area, including supervision of members, surveillance activities, and disciplinary activities;
    c. The total dollar amount of the applicant's annual revenues and expenses, in the aggregate and itemized by program area, itemized on the basis of the following categories and sub-categories, and any other categories that incorporate the applicant's revenues and expenses, with each category annotated as appropriate to further a clear understanding of the nature of the revenues and expenses reported;
        i. Revenues, including:
            A. Regulatory fees, including member dues and assessments and similar fees, for the purpose of funding regulation, itemized by category;
            B. Other member dues and assessments not included in subparagraph 1.c.i.A., above;
            C. Transaction fees, transaction services fees, trading privileges fees, and similar fees, itemized by category;
            D. Market information fees, including market data fees, itemized by product;
            E. Fines and penalties resulting from disciplinary and enforcement actions;
            F. Fees paid by issuers, including listing fees and issuer services;
            G. Investments, including dividend and interest income;
            H. Other revenues, itemized as appropriate.
        ii. Direct expenses incurred for the applicant's regulatory activities, including supervision of members, surveillance activities, and disciplinary activities not included in allocated costs reported under subparagraph 1.c.iii. below, including, but not limited to:
            A. Personnel expenses, including compensation expenses;
            B. Compensation schedules for the Chief Regulatory Officer and all other senior regulatory personnel, including bonus ranges;
            C. Training;
            D. Expenses incurred in connection with examinations, investigations, and enforcement actions, reported separately;
            E. Information technology expenses, itemized by categories including data center costs, systems hardware and software, systems consultant fees, and electronic surveillance systems;
            F. Costs associated with any contract or other agreement with a regulatory subsidiary or another self-regulatory organization that provides (whether pursuant to contract, agreement, or rule) regulatory services to or on behalf of the applicant, disclosed separately;

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G. Occupancy and other overhead expenses;
H. Professional services, including auditing;
I. Depreciation and amortization; and
J. Other expenses, itemized as appropriate.

iii. Allocated expenses incurred by non-regulatory personnel attributable to regulation-related activities of other divisions and offices or personnel of other divisions and offices that are not formally a part of the association or association's regulatory program, including, but not limited to:

A. Personnel expenses, based on a stated percentage of employee hours devoted to regulation-related activities;
B. Information technology expenses;
C. Occupancy and other overhead expenses; and
D. Other allocated costs including, but not limited to legal fees related to regulatory activities and expenses of regulatory and business conduct committees.

2. An itemization of non-regulatory expenses, including, but not limited to, personnel expenses, program expenses, systems and other technology expenses, consultants and advisors, and overhead.
3. A discussion of information necessary to an understanding of the financial condition of the applicant and any material changes in its financial condition.
4. A discussion of any unusual or infrequent events or transactions or any significant economic changes that have had a material effect on the financial condition of the applicant and any known demands, commitments, events or uncertainties that would result in or are reasonably likely to result in a material change in financial condition. The discussion should focus on material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future financial condition.
5. A description of any significant business development involving the applicant including reorganization, merger or consolidation, acquisition or disposition of significant assets, or any other material change in the business or operations of the applicant.
6. A description of all material contracts and all material related party transactions. In this context, "material" contracts and related party transactions are those to which the applicant or any facility or regulatory subsidiary of the applicant is a party; any director, nominee for director, officer, member, lessee, or any immediate family member of any of the foregoing is also a party; and either the amount involved exceeds $60,000 or it is not a contract made in the ordinary course of business of the applicant or any facility or regulatory subsidiary of the applicant.
7. A description of material commitments by the applicant for expenditures as of the end of the latest fiscal period, and indicate the general purpose of such commitments and the anticipated source of funds needed to fulfill such commitments.
8. Any charitable contributions of the applicant in excess of $1,000, whether made directly or indirectly, to a charity in which an executive officer or director of the applicant, or any of their immediate family members, is an executive officer or director of the charity.
9. A table detailing the compensation of the five most highly compensated executives of the applicant which table shall be modeled after the compensation table required to be disclosed by public reporting companies in Item 402(b) of Regulation S-K.

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10. A description of the material terms of the employment agreements of the five most highly compensated executives of the applicant.
11. A description of the compensation provided to directors.

Exhibit J — For each affiliate of the applicant (unless the information has been provided pursuant to Exhibit I), provide separate financial statements for the latest fiscal year. Such financial statements shall consist, at a minimum, of a balance sheet and an income statement and a statement of cash flows with such footnotes and other disclosures as are necessary to avoid rendering the financial statements misleading. If any affiliate is required by another Commission rule to submit annual financial statements, a statement to that effect, with a citation to the other Commission rule, may be provided along with a copy of the financial statements prepared pursuant to such other Commission rule.

Exhibit K — For each affiliate of the applicant and for any unaffiliated entity that operates an SRO trading facility, provide the following information (unless the information has been provided pursuant to another Exhibit to this form):

1. Name and address of organization.
2. Form of organization (e.g., association, corporation, partnership, etc.).
3. Name of state and statute citation under which organized. Date of incorporation in present form.
4. Brief description of nature and extent of affiliation.
5. Brief description of business or functions. Description should include responsibilities with respect to operation of the SRO trading facility and/or execution, reporting, clearance, or settlement of transactions in connection with operation of the SRO trading facility.

In addition to the foregoing, for each affiliate of the applicant and for any unaffiliated entity that operates an SRO trading facility, provide the following information (unless the information has been provided pursuant to another Exhibit to this form):

1. A copy of the constitution.
2. A copy of the articles of incorporation or association, including all amendments.
3. A copy of existing by-laws or corresponding rules or instruments.
4. The name and title of the present officers, governors, members of all standing committees, or persons performing similar functions.
5. An indication of whether such business or organization ceased to be associated with the applicant during the previous year, and a brief statement of the reasons for termination of the association.

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Exhibit L Describe the manner of operation of any SRO trading facility. This description should include the following:

1. The means of access to the SRO trading facility.
2. Procedures governing entry and display of quotations and orders in the SRO trading facility.
3. Procedures governing the execution, reporting, clearance and settlement of transactions in connection with the SRO trading facility.
4. Proposed fees.
5. Procedures for ensuring compliance with SRO trading facility usage guidelines.
6. The hours of operation of the SRO trading facility, and the date on which applicant intends to commence operation of the SRO trading facility.
7. Attach a copy of the users' manual.
8. If the applicant proposes to hold funds or securities on a regular basis, describe the controls that will be implemented to ensure safety of those funds or securities.

Exhibit M A complete set of all forms pertaining to:

1. Application for membership, participation, or subscription to the applicant.
2. Application for approval as a person associated with a member, participant, or subscriber of the applicant.
3. Any other similar materials.

Exhibit N A complete set of all forms of financial statements, reports, or questionnaires required of members, participants, subscribers, or any other users relating to financial responsibility or minimum capital requirements for such members, participants, or any other users. Provide a table of contents listing the forms included in this Exhibit N.

Exhibit O A complete set of documents comprising the applicant's listing applications, including any agreements required to be executed in connection with listing and a schedule of listing fees. If the applicant does not list securities, provide a brief description of the criteria used to determine what securities may be traded on the applicant or on any facility of the applicant. Provide a table of contents listing the forms included in this Exhibit O.

Exhibit P Provide an organizational chart showing the relationship between and among the applicant, any facility of the applicant, and any affiliate(s) of the applicant or a facility of the applicant. In addition, provide the following information for the applicant and each facility and affiliate:

1. Full legal name.
2. The form of organization (e.g., corporation, limited liability company) and the jurisdiction and statute citation under which the applicant, the facility or the affiliate is organized.
3. Ownership structure.
4. Whether the applicant, facility or affiliate is a reporting issuer under Section 12 of the Exchange Act.
5. Whether the applicant, facility or affiliate is registered with the Commission as a broker or dealer, investment adviser, or otherwise.
6. Whether and how a facility or affiliate possesses the power, directly or indirectly, to direct or cause the direction of the management and policies of the applicant, whether through ownership of voting securities, by contract, or otherwise.
7. Specifically describe the ability of the facility or affiliate, through governance provisions or otherwise, to exercise any influence or control over the applicant's regulatory responsibilities.

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Exhibit Q Provide the following information:

1. A description of each class or series of outstanding securities or other ownership interest (including debt) of each Disclosure Entity that includes:
   a. The title of the class of securities or other ownership interest;
   b. The total number of securities or other ownership interest issued and outstanding;
   c. Any restrictions on ownership, voting, transfers, or other disposition of such securities or other ownership interest;
   d. If the securities are publicly traded, the market(s) where they trade; and
   e. Any other material information relating to ownership of the Disclosure Entity.
2. Provide the following information with regard to any person, alone or together with its Related Persons, that directly or indirectly beneficially owns more than 5% of any class of securities or other ownership interest in a Disclosure Entity:

   a. If the person is a corporation, general partnership, limited partnership, syndicate or other group of persons, provide the following information:
      i. Name;
      ii. The state or other place of its organization;
      iii. Its principal business;
      iv. The address of its principal business; and
      v. The address of its principal office.
   b. If the person is a natural person, provide the following information:
      i. Name;
      ii. Residence or business address; and
      iii. Present principal occupation or employment and the name, principal business and address of any corporation or other organization in which such employment is conducted.
      iv. Whether such person is an officer or director of the Disclosure Entity.
   c. For each person, state the aggregate number and percentage of the shares of a class of securities or other ownership interest that are beneficially owned. In addition:
      i. Indicate the aggregate number of shares or ownership interest as to which there is sole power to vote or to direct the vote, shared power to vote or to direct the vote, sole power to dispose or to direct the disposition, or shared power to dispose or to direct the disposition.
      ii. If any other person is known to have the right to receive or the power to direct the receipt of dividends from, or the proceeds from the sale of, such securities or other ownership interest, a statement to that effect should be included in response to this provision and, if such interest relates to more than 5% of the securities or other ownership interest, such person should be identified. A listing of the shareholders of an investment company registered under the Investment Company Act of 1940 or the beneficiaries of an employee benefit plan, pension fund or endowment fund is not required.

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3. Separately identify each Related Person whose ownership in a Disclosure Entity is included in the calculation of beneficial ownership required to be disclosed pursuant to Paragraph 2 of this Exhibit Q, and state the aggregate number and percentage of shares of a class of securities or ownership interest that are beneficially owned. In addition:
    a. Indicate the aggregate number of shares or ownership interest as to which there is sole power to vote or to direct the vote, shared power to vote or to direct the vote, sole power to dispose or to direct the disposition, or shared power to dispose or to direct the disposition.
    b. If any other person is known to have the right to receive or the power to direct the receipt of dividends from, or the proceeds from the sale of, such securities or other ownership interest, a statement to that effect should be included in response to this provision and, if such interest relates to more than 5% of the securities or other ownership interest, such person should be identified. A listing of the shareholders of an investment company registered under the Investment Company Act of 1940 or the beneficiaries of an employee benefit plan, pension fund or endowment fund is not required.
    c. Indicate whether the Related Person is an officer or director of the Disclosure Entity or the applicant.
4. In determining, for purposes of this Exhibit Q, any percentage of a class of any security of a Disclosure Entity, such class shall be deemed to consist of the outstanding securities of such class, exclusive of any securities of such class held by or for the account of the Disclosure Entity or a subsidiary of the Disclosure Entity.
5. For each person and its Related Person, state whether and how such person, alone or with its Related Persons, possesses the power, directly or indirectly, to direct or cause the direction of the management or policies of the Disclosure Entity, whether through ownership of voting securities, by contract, or otherwise.
6. If the Disclosure Entity is a partnership, provide a list of all general partners and those limited and special partners that have the right to receive upon dissolution, or have contributed, more than 5% of the partnership's capital.
7. Describe any contracts, arrangements, understandings or relationships (legal or otherwise) among the persons identified in Paragraphs 2.a, 2.b, and 3 of this Exhibit Q and between such persons and any other person with respect to any securities or other ownership interest of the Disclosure Entity, including but not limited to transfer or voting of any of the securities or other ownership interest, finder's fees, joint ventures, loan or option arrangements, put or calls, guarantees of profits, division of profits or loss, or the giving or withholding of proxies, and name the persons with whom such contracts, arrangements, understandings or relationships have been entered into. Include such information for any of the securities
or other ownership interest that are pledged or otherwise subject to a contingency, the occurrence of which would give another person voting power or investment power over such securities or other ownership interest, except that disclosure of standard default and similar provisions contained in loan agreements need not be included.

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Exhibit R Describe the applicant's criteria for membership. Describe conditions under which members may be subject to suspension or termination with regard to access to the association. Describe any procedures that will be involved in the suspension or termination of a member.

Exhibit S Provide an alphabetical list of all members, participants, subscribers or other users, including the following information:

1. Name;
2. Date of election to membership or acceptance as a participant, subscriber or other user;
3. Principal business address and telephone number;
4. If member, participant, subscriber or other user is an individual, the name of the entity with which such individual is associated and the relationship of such individual to the entity (e.g., partner, officer, director, employee, etc.);
5. Describe the type of activities primarily engaged in by the member, participant, subscriber, or other user (e.g., floor broker, specialist, odd lot dealer, other market maker, proprietary trader, non-broker dealer, inactive or other functions). A person shall be "primarily engaged" in an activity or function for purposes of this item when that activity or function is the one in which that person is engaged for the majority of their time. When more than one type of person at an entity engages in any of the six types of activities or functions enumerated in this item, identify each type (e.g., proprietary trader, Registered Competitive Trader and Registered Competitive Market Maker) and state the number of members, participants, subscribers, or other users in each; and
6. The class of membership, participation or subscription or other access.

Exhibit T Provide a schedule for each of the following:

1. The securities listed on the applicant or any facility of the applicant, indicating for each the name of the issuer and a description of the security;
2. The securities admitted to unlisted trading privileges, indicating for each the name of the issuer and a description of the security;
3. The unregistered securities admitted to trading on the applicant or any facility of the applicant that are exempt from registration under Section 12(a) of the Act. For each security listed, provide the name of the issuer and a description of the security, and the statutory exemption claimed (e.g., 17 CFR 240.12a-6); and
4. Other securities traded on the applicant or any facility of the applicant, including for each the name of the issuer and a description of the security.
5. If a class of securities of a the applicant, an SRO trading facility of the applicant, or any affiliate of the applicant or an SRO trading facility of the applicant, is listed on, approved for trading on, or trades pursuant to the rules of, the applicant, an explanation of the process for monitoring initial and ongoing compliance by the security with the applicant's listing rules and trading in the security by the applicant's members, as well as the process for enforcing the applicant's listing rules, trading rules, and federal securities laws with respect to the listing and trading of the securities.

Exhibit U Provide the name and address for the location of the applicant's books and records.

§§ 249.801, 249.802, and 249.803 [Removed]

18. Sections 249.801, 249.802, and 249.803 are removed.

Dated: November 18, 2004.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 04–26153 Filed 12–7–04; 8:45 am]

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