



Securities Industry Association

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December 5, 2003

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: Proposed Rule Change by the New York Stock Exchange, Inc. Relating to the Amendment and Restatement of the Constitution of the Exchange to Reform the Governance and Management Architecture of the Exchange, Release No. 34-48764; File No. SR-NYSE-2003-34, 68 Federal Register 64380 (Nov. 13, 2003)

Dear Mr. Katz:

The Securities Industry Association¹ ("SIA") acknowledges the considerable efforts of the New York Stock Exchange, Inc. ("NYSE" or "the Exchange") under its interim Chairman, John S. Reed, to address important governance concerns in a very short time frame. With this rule proposal, the Exchange has responded swiftly to concerns about conflicts of interest and other deficiencies regarding the Exchange's governance structure. The leadership of Mr. Reed, and of Securities and Exchange Commission ("SEC") Chairman William Donaldson, is doing much to help restore public trust and confidence in the NYSE.

¹ The Securities Industry Association, established in 1972 through the merger of the Association of Stock Exchange Firms and the Investment Bankers Association, brings together the shared interests of more than 600 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs nearly 800,000 individuals. Industry personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2002, the industry generated \$222 billion in domestic revenue and \$356 billion in global revenues. (More information about SIA is available on its home page: www.sia.com.)



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Rather than discuss specific details of the governance proposal, which we broadly favor, we would like to highlight our concern about unresolved conflicts of interest between the dual roles of the NYSE and other self-regulatory organizations (“SROs”) as regulators of their members, and as standard-setters for marketplaces with which those members compete. This current governance proposal, while a constructive transitional step to address many of the issues that have been raised, does not seek to separate these regulatory functions.² While this round of changes to the NYSE’s structure is an excellent first step,³ we hope that it will be followed by further steps to improve the NYSE’s regulatory structure by separating clearly the NYSE’s member regulatory function from its function as a marketplace regulator.

Additionally, we renew our previous call for the SEC to take this opportunity to address wider changes to the entire system of self-regulation.⁴ SIA believes that it is time to determine whether our current self-regulatory system offers sufficient checks and balances, or whether a different or improved model would provide a greater level of investor protection and regulatory efficiency.

SROs face increasing conflicts between their dual roles as market operators and promoters and as regulators of members that offer products and services that compete

² By creating the new position of Chief Regulatory Officer, who will report directly to the Board, the proposal may strengthen the independence of the NYSE’s regulatory function from the economic interests of its marketplace. However, the proposal does not address separation of member firm regulation from marketplace regulation.

³ The NYSE’s filing appropriately emphasizes that it is proposing a “transitional structure” and that it “cannot be certain that further changes in our architecture may not be warranted.” 68 Fed. Register at 64381.

⁴ In recent Congressional testimony, we argued for both of the points made in this letter: (i) that near-term action should be taken to “separate clearly the NYSE’s member regulatory function from its function as a marketplace;” and (ii) that “[a]dditional action to address the structure of self-regulation more broadly . . . should also be considered.” Testimony of Marc E. Lackritz, President, Securities Industry Association, before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, Committee on Financial Services, U.S. House of Representatives, October 16, 2003 at 3 (available at <http://www.sia.com/testimony/html/lackritz10-15-03.html>).



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with their markets. Moreover, broker-dealers are subject to many different and often conflicting SRO regulatory regimes. As a result, firms experience increased regulatory costs, uncoordinated or duplicative examinations, and other regulatory inefficiencies.⁵ These redundancies result in higher costs for services being passed on to investors. Investor protection may also suffer since differing regulatory requirements of various SROs may create the possibility of “regulatory arbitrage” (moving from regulation under one SRO to regulation under a different one with more lenient requirements).

The current initiative to reform the governance structure at the NYSE offers a perfect opportunity to address longstanding concerns about the need to restructure the role of SROs in our markets generally. SIA prepared a White Paper in 2000⁶ to examine these concerns and evaluate the advantages and disadvantages of six different approaches to self-regulation. These ranged from maintaining the *status quo* to simply abolishing self-regulation and moving the job of the SROs into the SEC. Many of the trends driving our concern about these issues (e.g., the growing importance of electronic communications networks that compete with exchanges for trading volume, internalization of order flow, decimalization, and continual innovation in technology and products) are in many cases more significant today⁷ than they were when our White Paper was prepared.

⁵ In May 2002, the General Accounting Office issued a report outlining concerns about multiple self-regulatory efforts and related competitive issues. As a follow-up to that report, the NYSE and NASD solicited comment on ways to improve regulatory consistency and the examination process. SIA suggested 19 areas where rule inconsistencies should be resolved. See Securities Markets: Competition and Multiple Regulators Heighten Concerns about Self-Regulation, U.S. General Accounting Office, May 2002, GAO-02-362, available at www.gao.gov/new.items/d02362.pdf; letter to Barbara Z. Sweeney and Donald Van Weezel from Michael H. Stone and Christopher Franke, August 19, 2002, available at http://www.sia.com/2002_comment_letters/pdf/NYSE-NASDinconsistencies.pdf. In addition to increasing costs for investors, these regulatory costs place U.S. firms at a disadvantage to foreign competitors.

⁶ A recently updated version of our White Paper is available at <http://www.sia.com/testimony/html/whitepaper1.html> and an accompanying set of charts is at <http://www.sia.com/testimony/pdf/WhitePaperCharts.pdf>.

⁷ While ECN volume data is difficult to track, SIA’s Research Department has obtained data showing that ECN volume has risen from 165 billion shares traded in 2000 to 308 billion shares traded in 2002, and is



While none of the proposals advanced in our White Paper is without drawbacks, the proposal that attracted the most attention, and strong support in many quarters of our industry, calls for creation of a single national SRO. Under that approach, denoted in our White Paper as the “hybrid SRO,” regulation would be focused in a single self-regulatory organization (“Central SRO”) responsible for firm oversight and rules generally applicable to all markets (e.g., front running, manipulation and free-riding and withholding). Individual markets (“market SROs”) would retain responsibility for writing and enforcing market-specific rules, such as trading and listing requirements, qualification of floor specialists or market makers, trading halts and suspensions, market membership rules, etc., that are unique to individual marketplaces. This model envisions that the Central SRO would be governed by a board of directors that would represent the full array of public constituencies that are affected by broker-dealer regulation. The Central SRO could be funded through a combination and restructuring of existing SRO revenue sources, particularly regulatory fees, assessments and market data revenue, as well as a fee charged to market SROs for services provided by the Central SRO on behalf of market SROs.

We encourage the NYSE to continue its effort to resolve its dual regulatory roles in order to ensure public trust and confidence in the Exchange and our markets. Also, we believe that a restructuring of the entire self-regulatory system, possibly along the lines of a hybrid SRO, might be the best way of ensuring that self-regulation continues to be an effective force in protecting investors’ interests and in ensuring the health and competitive vitality of our capital markets.



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Thank you for giving SIA the opportunity to comment on the NYSE's proposed changes to its governance structure. This is an important first step toward what we hope will be a larger goal of comprehensively addressing conflicts of interest within the self-regulatory structure. If you have any questions concerning the above, please do not hesitate to contact me or George Kramer, SIA's Acting General Counsel, at 202-216-2000.

Sincerely,

Marc E. Lackritz
President

Cc: Chairman William H. Donaldson, U.S. Securities and Exchange Commission
Commissioner Paul S. Atkins, U.S. Securities and Exchange Commission
Commissioner Roel C. Campos, U.S. Securities and Exchange Commission
Commissioner Cynthia A. Glassman, U.S. Securities and Exchange Commission
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John S. Reed, Chief Executive Officer, New York Stock Exchange, Inc.
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Robert L.D. Colby, Deputy Director, Division of Market Regulation, U.S. Securities and Exchange Commission
Nancy J. Sanow, Assistant Director, Office of Market Supervision, Division of Market Regulation, U.S. Securities and Exchange Commission