

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52774; File No. SR-NSX-2005-07)

November 15, 2005

Self-Regulatory Organizations; National Stock Exchange; Order Approving Proposed Rule Change, and Amendment Nos. 1, 2, and 3, Thereto, Relating to the Creation of a Regulatory Oversight Committee

I. Introduction

On August 1, 2005, the National Stock ExchangeSM (“NSX”SM or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to create a Regulatory Oversight Committee (“ROC”). Notice of the proposed rule change, as amended, was published for comment in the Federal Register on October 14, 2005.³ No comments were received regarding the proposal. This order approves the proposed rule change, as amended.

II. Description of the Proposed Rule Change

NSX proposes to amend the text of Article VI, Section 1.1 of the Exchange’s By-Laws to allow it to create, and specifically identify, a ROC that would be subject to the control and supervision of NSX’s Board of Directors (“NSX Board”). The NSX also proposes to establish a Regulatory Oversight Committee Charter (“ROC Charter”) that would set forth the functions, scope of responsibilities and composition of the ROC.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 52573 (October 7, 2005), 70 FR 60113 (“Notice”).

NSX filed the proposed rule change in accordance with undertakings made by it and as set forth in Section III.F.1. of the Order Instituting Administrative and Cease-And-Desist Proceedings Pursuant to Sections 19(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Sanctions entered May 19, 2005.⁴ In its filing, NSX represented that the ROC Charter would include provisions that mirror the terms of its undertaking to the Commission and certification procedures that are consistent with the certification procedures contained in the Order.⁵

Pursuant to the ROC Charter, the ROC shall be responsible for overseeing all of NSX's regulatory functions and responsibilities and to advise regularly NSX's Board about NSX's regulatory matters.⁶ Specifically, the ROC shall:⁷ (i) oversee NSX's regulatory functions to enforce compliance with the federal securities laws and NSX rules, including monitoring the design, implementation, and effectiveness of NSX's regulatory programs; (ii) recommend to the NSX Board an adequate operating budget for NSX's regulatory functions; (iii) approve the promulgation, filing, or issuance of new rules, rule amendments, rule interpretations, and regulatory circulars; (iv) take any other action necessary to fulfill its oversight and advisory responsibilities; and (v) adopt policies and procedures to ensure the independence of NSX's Chief Regulatory Officer (the "CRO"). The ROC shall also:

⁴ See In the Matter of National Stock Exchange and David Colker, Securities Exchange Act Release No. 51715 (May 19, 2005) ("Administrative Order") at Section III.F.1.

⁵ See Notice.

⁶ Proposed ROC Charter.

⁷ Proposed ROC Charter, Section A.

- be authorized to retain, at NSX’s expense, outside counsel and consultants as it deems appropriate to carry out its responsibilities;⁸
- on at least an annual basis, report to the NSX Board on the state of the Exchange’s regulatory program; and⁹
- create and maintain complete minutes of all of its meetings, and create and maintain records reflecting the ROC’s recommendations or proposals made to NSX Board, and NSX Board’s decision as to each such recommendation proposal.¹⁰

In the event that the ROC’s recommended operating budget for NSX’s regulatory functions either: (1) is less than the previous year’s budget by a material amount, (2) is rejected by the NSX Board, (3) is reduced by the NSX Board by a material amount, or (4) is altered by the NSX Board in a manner that, in the judgment of the ROC, materially impairs the ability of NSX to meet its regulatory obligations, then NSX shall, within fifteen (15) business days of such NSX Board action, notify the Director of the Commission’s Division of Market Regulation in writing, providing copies of all minutes and other records reflecting the ROC’s budget proposal and the NSX Board’s decision regarding such proposal.¹¹

The CRO shall certify compliance with the required items of the Administrative Order to the ROC on a form and frequency basis set by the ROC, and shall have the authority to require

⁸ Proposed ROC Charter, Section B.

⁹ Proposed ROC Charter, Section C.

¹⁰ Proposed ROC Charter, Section D.

¹¹ Proposed ROC Charter, Section E.

such additional compliance certification from the staff as he deems appropriate and in such forms as he may prescribe.¹²

In accordance with the functions and responsibilities set forth above, the ROC shall perform certain oversight functions with respect to the CRO and other regulatory personnel. Specifically, NSX represented in its filing that the ROC shall:¹³

- review with the Exchange’s CRO and other appropriate regulatory personnel various aspects of the design, implementation, and effectiveness of NSX’s regulatory programs;
- review, revise, or approve the CRO’s recommendation for a regulatory budget to formulate the ROC’s recommendation of an adequate operating budget and staffing level for NSX’s regulatory function to the Board;
- review, evaluate, and, if appropriate, recommend to the Board the implementation of any and all actions recommended by the CRO and the Regulatory Services Division (“NSX Regulatory Division”) to fulfill the NSX Regulatory Division’s and the ROC’s oversight and advisory responsibilities;
- assess the performance of the CRO and review the CRO’s assessment of the NSX Regulatory Division’s staff in fulfilling their responsibilities and recommend compensation and personnel actions to the NSX Board; and
- review, amend, approve or reject the CRO’s recommendations respecting the promulgation, filing, or issuance of new rules, rule amendments, rule interpretations, and regulatory circulars, including the approval (or ratification) of

¹² Proposed ROC Charter, Section A.

¹³ See Notice.

all regulatory circulars issued by the NSX within thirty five days of the issuance of such regulatory circulars.

In addition, NSX represented that, on at least an annual basis, the ROC will review the structural protections that separate NSX's regulatory function from its commercial interests by reviewing the supervisory responsibilities of its Chief Executive Officer ("CEO") and CRO. Further, the ROC will take all steps necessary to provide reasonable assurance that NSX is and remains in compliance with the Administrative Order and will take any other action necessary to fulfill its oversight and advisory responsibilities.¹⁴

The ROC shall be comprised of no less than three members, who have been appointed by NSX's Chairman with the approval of the NSX Board in a composition consistent with federal securities laws and NSX's By-Laws and Rules. At a minimum, the ROC members shall not be, nor have been during the preceding three years, employees of NSX or any NSX member firm. The ROC shall elect a Chairperson from among its members.¹⁵

III. Discussion and Commission Findings

The Commission has reviewed the proposed rule change, as amended, and finds that it is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.¹⁶ Specifically, the Commission finds that the proposed rule change, as amended, furthers the objectives of Section 6(b)(1)¹⁷ of the Act, which requires the Exchange to be so organized and have the capacity to be able to carry out the purposes of the Act and to

¹⁴ Id.

¹⁵ Proposed ROC Charter.

¹⁶ In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹⁷ 15 U.S.C. 78f(b)(1).

comply, and to enforce compliance by its members, with the Act and the rules of the Exchange. In addition, the Commission finds that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act,¹⁸ which requires, among other things, that the rules of a national securities exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

An exchange's governance structure should be designed to assure that its regulatory function is strong, vigorous, and sufficiently independent and insulated from improper influence from management or any regulated entity. In the Commission's view, the proposal is designed to advance this goal. The proposed amendments provide for a ROC which will be composed of members that shall not be, nor have been during the preceding three years, employees of NSX or any NSX member firm. The ROC will be responsible for oversight of all of NSX's regulatory functions and responsibilities, including, among other things, approving new NSX rules and adopting policies and procedures to ensure the independence of the NSX's CRO. Also, the ROC will review, on at least an annual basis, the structural protections that separate NSX's regulatory function from its commercial interests by reviewing the supervisory responsibilities of NSX's CEO and CRO.¹⁹ The Commission believes that these proposed amendments to the NSX's governance structure will add a degree of independence that should serve to insulate NSX's regulatory activity from its economic interests. As noted above, the Commission notes that NSX filed the proposed rule change in accordance with its undertakings as set forth in the Administrative Order, and represented that the proposed rule change includes provisions that

¹⁸ 15 U.S.C. 78f(b)(5).

¹⁹ See supra note 14 and accompanying text.

mirror the terms of the undertaking. The Commission believes that in this context, the Exchange's proposal is consistent with the statutory requirements under Section 6(b)(1) of the Act.²⁰ The Commission notes that it is in the process of reviewing a range of governance issues relating to self-regulatory organizations ("SROs"), including possible steps to strengthen the framework for the governance of SROs and ways to improve the transparency of the governance procedures for all SROs, and has proposed rules in furtherance of this goal, including proposed rules relating to an exchange's ROC.²¹ Depending on the results of the proposed rules, NSX may be required to make further changes to strengthen its governance structure and ensure that its ROC continues to comply with federal securities laws.

²⁰ 15 U.S.C. 78f(b)(1).

²¹ See Securities Exchange Act Release No. 50699 (November 18, 2004), 69 FR 71126 (December 8, 2004).

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²² that the proposed rule change (File No. SR-NSX-2005-07) and Amendment Nos. 1, 2, and 3, thereto be, and hereby are, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²³

Jonathan G. Katz
Secretary

²² 15 U.S.C. 78s(b)(2).

²³ 17 CFR 200.30-3(a)(12).