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By Electronic Mail and U.S. Mail

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

Re: **File No. S7-39-04**
Self-Regulatory Organizations — Proposed Rule

Dear Mr. Katz:

The American Stock Exchange LLC ("Amex" or "Exchange") appreciates the opportunity to submit the following comments with respect to the Commission's proposals pertaining 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 (File No. S7-39-04).[1] We are also transmitting to the Commission today a separate letter with our comments on the Commission's closely related concept release that pertains to issues related to the self-regulatory system of the securities industry.[2]

The Amex shares the Commission's objectives of strengthening the governance and administration of SROs, maintaining an adequate separation between the regulatory functions of SROs and their market operations and other commercial interests, and providing greater transparency relating to each SRO's governance, regulatory programs, finances, ownership structure and other matters. Indeed, the Amex believes that achieving these objectives is crucial to the success of our business.

While the Amex shares the Commission's objectives, we are not in full agreement with the means proposed to achieve them. Accordingly, the Amex is specifically

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[1] Securities Exchange Act Release No. 50699 (November 18, 2004), 69 Fed. Reg. 71126 (December 8, 2004) (the "Release").

[2] Securities Exchange Act Release No. 50700 (November 18, 2004), 69 Fed. Reg. 71256 (December 8, 2004) (the "Concept Release").

commenting on four aspects of the proposals relating to (1) the mandated governance provisions, (2) the dedicated use of SRO "regulatory funds" to fund an SRO's regulatory programs, (3) the treatment of certain information deemed to be "regulatory information" and (4) confidentiality of certain sensitive information under the new SRO reporting requirements. The Amex also urges the Commission to recognize that these extensive proposed changes, if implemented, will require some difficult adjustments and will necessitate an adequate transition or phase-in period.

I. Concerns Regarding the Mandated Governance Provisions

In light of regulatory and legal concerns at multiple markets, including the Amex, over the last several years, the Release would impose major changes in the historical framework of SRO governance. These changes would include (1) a majority independent board; (2) fully independent Nominations, Governance, Audit, Compensation, and Regulatory Oversight Committees (or their equivalent); (3) strict reporting lines of the Chief Regulatory Officer to the independent Regulatory Oversight Committee and giving that committee sole responsibility for budgeting decisions with respect to regulatory operations; and (4) the filing of quarterly and annual regulatory reports detailing key aspects of the SRO's regulatory program. The Amex's experience over the last five years as the subsidiary of a market regulator, and with a largely independent board composed of many highly respected and accomplished individuals with no ties to the securities industry, leads us to believe that this approach is not a "single bullet" panacea and could actually be incompatible with the achievement of the objectives spelled out in the release. While we acknowledge the existence of real concerns and challenges in maintaining public confidence, we hope that these can be addressed by more tried and true measures.

We believe that the proposal in the Release does not sufficiently acknowledge the role that substantive experts and financially committed owners can play in building successful institutions with unquestioned integrity. The public interest is best served when exchanges, like other companies with public interest obligations in corporate America, are guided by knowledgeable decision-makers with a strong interest in and a clear duty to the company that they serve. It is in every successful company's interest to have a reputation for reliability and honesty and, therefore, the conflict between a market's business and its regulatory side is perhaps not as great as the Release envisions.

Much of the Release fails to define adequately how either the public or the company is best served by removing knowledgeable owners and replacing them with outside governors who arguably lack the full business perspective to fulfill their roles without a balance of "insiders." Moreover, the Release fails to make it clear to whom these outside governors owe their loyalty. If to the public, which public -- market users with competing concerns of price versus speed? There is no uniform public interest, and it is indeed a solidly open question of whether the public is better protected by a governance structure with unclear duties such as a generic duty to the "public good" and limited industry-specific skills.

In addition to the board membership requirements, the Commission's additional requirement that certain key committees consist exclusively of independent directors would eliminate the ability of members of the SRO to participate in many of the SRO's most important functions. We believe that this would weaken the ability of some of these committees to function properly due to the absence of industry expertise. While we acknowledge and accept the important role of independent directors in insuring that the rights of the investing public are protected, we believe that it is equally important that members and other market participants with critical industry expertise have more than a de minimis role in the process. Only by striking an appropriate balance between the two types of directors in carrying out the critical functions of the board will markets be able to operate in optimal fashion and properly serve the public interest.

This requirement is likely to be problematic for another reason as well – a number of the exchanges may find it difficult to find enough qualified independent directors with sufficient expertise to satisfy all of these committees. The proposals in the Release are based on more of a public company model where there may be a large pool of candidates available with the knowledge and skills necessary to fulfill a director's responsibilities. We believe, however, that the highly specialized nature of the securities industry requires people who have an in-depth understanding of the operations of the securities markets in order to perform their leadership functions adequately. This is a more limited pool of candidates and many of them might be determined to be conflicted under the Commission's proposed determination of independence.

We also are concerned that removing the Chief Executive Officer (CEO) from any responsibility for regulation may be a mistake as well. While an independent Regulatory Oversight Committee is part of the solution, it is also equally desirable to have the CEO engaged with and accountable for regulatory matters as well, rather than letting him/her "off the hook" as the rules proposed in the Release seem to do. While we need to address the obvious problems and abuses in the current SRO model, the Amex believes that these difficulties can be solved by simpler and less sweeping proposals than some of those discussed in the Release, which could threaten the foundations of the free market economic system that has served this country well for generations.

Finally, we note that the public company model also seems to be the basis of much of the additional disclosure that would be required of the SROs if the proposals in the Release are implemented. For example, the changes mandated with regard to the Form 1 process closely parallel the processes governing the filing of Forms 10-K, 10-Q, etc. We are concerned with the potential scope of the reporting obligations that would be required. The Amex applauds the objective of market transparency and we certainly favor taking reasonable measures to improve transparency. However, as a competitive organization, we need to be concerned with costs and burdens as well and would ask that a more appropriate balance be struck between cost and transparency. We believe that the goal of transparency can be achieved without mimicking the "Fortune 500" reporting requirements in all markets.

II. Dedicated Use of SRO Regulatory Funds

The Commission has proposed in the Release that exchanges and associations be required to use "regulatory funds" only to fund regulatory obligations. Monies collected from regulatory fees, fines or penalties would be used "exclusively to fund the regulatory operations and other programs of the exchange or association related to its regulatory responsibilities"[3] and to keep the necessary books and records to evidence compliance. The Commission's view is that these proposed requirements would help "to ensure that an SRO's regulatory activities are properly funded and that the SRO is not abusing its regulatory authority."[4] The Release also states that, "The 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."[5]

For a number of reasons, the Amex's view is that this proposed restriction on the use of regulatory funds will be much less helpful in achieving the foregoing objectives than the Release suggests. The Release describes regulatory fees as including "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."[6] This presupposes that the Amex and other SROs have, or should have, dedicated revenue streams that are used solely and exclusively for the purpose of funding the SRO's regulatory program. This is not currently the case at the Amex, where we have generally viewed our revenues as fungible and have not, for example, analyzed listing fees in terms of an amount or percentage that is earmarked for regulatory activity and an amount or percentage that is earmarked for the business side.

This is not to say that there are not sources of revenue that emerge specifically from the Exchange's SRO function – our CRD registration fees, disciplinary fines and certain examination fees would meet the criterion of having a regulatory base. And we could probably perform an analysis of our issuer fees and ascertain what portion of those could logically be used to provide dedicated support to the Listing Qualifications regulatory function. But breaking out our fees, fines and penalties in this manner would result in a total dedicated dollar amount that would most likely be well short of the amount needed to fund an adequate regulatory program at the Amex. Revenue from sources that are specifically regulatory in nature is simply not sufficient to cover the full cost of our regulatory program, and subsidization from other revenue sources is required. The reason is straightforward – most of our revenues are generated from our basic business, consisting of the transactions that take place on the Exchange and the related market data that we provide, rather than from our regulatory activity.

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[3] 69 Fed. Reg. 71142.

[4] *Id.*

[5] *Id.*

[6] *Id.*

Consequently, while the Amex would have no problem complying with the requirement that its "regulatory funds" be used exclusively to fund its regulatory responsibilities, this would not serve as a useful measure of the adequacy of funding for the Exchange's regulatory programs nor as a helpful limit on the spending of these funds for non-regulatory purposes. Instead, it is more useful to look at the expense side of the ledger rather than the revenue side by determining the direct and indirect costs of an adequately funded regulatory program, considered in the context of the Exchange's cash flow position and overall profitability. That type of analysis would better support a determination of the proper level of other expenditures such as executive compensation and/or distributions to owners instead of a prohibition on the use of "regulatory funds" for such purposes. The Amex believes that the additional detailed disclosure of SRO regulatory expenses that would be required under the rules proposed in the Release could be particularly useful in identifying the parameters of an effective regulatory program. We are committed to full funding of such a regulatory program at the Amex, no matter what percentages of our revenues are classified as regulatory and non-regulatory, respectively.

One final concern we have with the proposal for dedicating or earmarking "regulatory funds" for the funding of regulatory programs and operations is that it begins to resemble a system of "fund accounting." In general, our view is that an entity such as the Amex that is operating in a free market environment, even though regulated, should not be required to base its prices upon the cost of each service provided or to establish separate funds for various activities. We believe that the proper approach is to utilize market pricing, within regulatory limits, for the services that the Exchange provides, with the objectives of covering our expenses, including the costs of an adequate regulatory program, and providing an adequate profit margin to cover necessary capital investments and economic rewards to owners.

III. Use of Regulatory Information

The Commission has also proposed in the Release that each SRO that is a national securities exchange or registered securities association be required "to establish policies and procedures reasonably designed to prevent the dissemination of regulatory information"[7] to persons not involved in carrying out the regulatory obligations and functions of that SRO. The proposed rule would also require that an SRO's policies and procedures be reasonably designed to prevent the use of regulatory information for any purpose other than for carrying out the SRO's regulatory obligations.

The foregoing requirement that "regulatory information" and certain other information be kept confidential and that SROs "not use information collected in the course of performing regulatory obligations for business or other non-regulatory purposes"[8] seems on its face to be reasonable and helpful in supporting "an independent

[7] *Id.*

[8] 69 Fed. Reg. 71143.

and effective regulatory function,"[9] but it is critical that careful attention be paid to the definition of "regulatory information." In particular, market data can have both regulatory and legitimate business purposes.[10] Simply because information can be used for regulatory purposes (e.g., time and sales), it should not be embargoed from the business side of an SRO as long as the business area does not obtain it from the regulatory area. In short, the restrictions should be based on the source of the data used by business and not on the fact that its content is also being used for regulatory purposes.

The Release proposes to define "regulatory information" as "any information collected by an exchange or association in the course of performing its regulatory obligations under the Exchange Act."[11] This definition contains ambiguities that need to be clarified. On one hand, the definition is focused on the fact that the information is collected by the SRO for regulatory purposes, so the proposed rule would clearly be violated if the regulatory area of the SRO shared the information with a business area for a non-regulatory purpose. On the other hand, once the information resides in the regulatory area, it is not clear from the definition whether or not the content of that information now governs its use for non-regulatory purposes. If so, then the business area would not be able to use that same information even if it were received independently.[12] The Amex would view such an outcome as highly problematic because it could preclude analytical and other business uses of data that the Amex has obtained independent of the regulatory function, simply because such data is also useful in carrying out the Exchange's regulatory duties and has been obtained by the regulatory area for that purpose as well.

Consequently, the Amex strongly urges the Commission to clarify that the definition of "regulatory information" for these purposes excludes information obtained by an SRO for business or other non-regulatory purposes from a source other than that

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[9] *Id.*

[10] Many forms of data from the Amex trading and comparison systems are used for both regulatory and business purposes. For example, our internal files containing order entry, order execution and trade comparison data are used in a variety of ways on the regulatory side as audit trail information for the purposes of analyzing individual transactions. This would allow, for example, the detection of wash sales, whether a firm traded ahead of one of its customers, and other irregularities.

On the business side, this same data, perhaps combined in different ways, is used for determining the structure and level of transaction charges, analyzing information on order flow to determine the major customers who participate in our marketplace and how best to meet their needs (including decisions regarding new technology requested by customers); providing trade exception reports, analysis of trade-throughs and other reports on execution quality to appropriate specialists and member firms; and to produce market quality reports, price improvement reports and trading analysis reports for business purposes, including marketing. The Amex believes that the continued ability to utilize this data on the business side is essential to allow the Exchange to compete effectively in an increasingly competitive environment.

[11] 69 Fed. Reg. 71142.

[12] Situations exist in which the business and regulatory areas of an SRO share a common database or other data source, with each using the data for its own purposes. At the Amex, for example, such a shared database contains Amex-only data on ticker information (quotes and trades), order entry and execution, audit trail, and clearance and comparison.

SRO's regulatory area, even though the same information collected by the regulatory area for its purposes is covered by the definition. In other words, while the regulatory area of an SRO and the information held and maintained therein should be "walled off" or segregated from an SRO's business area, the same information obtained independently for business purposes should not be embargoed just because it has a regulatory use or purpose. This is the current ISG procedure with respect to information that is shared among regulators and it has worked well over the years.[13]

IV. Confidentiality Concerns Regarding New Reporting Requirements

The Amex is concerned that certain of the proposed rules in the Release may require the public disclosure of information relating to the Exchange's regulatory programs that should be treated as confidential. We call to the Commission's attention the following specific examples, some of which, at a minimum, call for additional clarification.

Proposed Exhibit H to the registration statement presents a number of issues. Item 1 to Exhibit H requires a full description of the SRO's regulatory program.[14] Items 4 and 5 require a description of significant changes planned for the regulatory program, as well as new significant regulatory issues or events and their effect on the mission, strategy and future operations of the program.[15] Some of the information thereby required to be publicly disclosed in the registration statement and amendments, which must be posted on the SRO's website, may be better suited to confidential filings with the SEC. Our concern here is that publicly outlining the details of the regulatory plan and approach might actually be counterproductive to a successful regulatory operation by, for example, giving notice of planned focus. We are very concerned that the release of much of this information could potentially jeopardize the integrity of an SRO's regulatory program. At a minimum, it would be desirable for the Commission to clarify in the form the level of detail required.

In addition, Item 3 of Exhibit H requires the SRO to provide "a copy of any delegation plan or other contract or agreement relating to regulatory services"[16] that are provided to the SRO by another SRO, a regulatory subsidiary, or a regulatory subsidiary of another SRO. Without provision for confidential treatment of certain parts of the plan (e.g., specific financial terms), an SRO outsourcing its regulatory program might be severely disadvantaged from a commercial and regulatory perspective. In addition, public disclosure of the terms of the agreement may make it difficult to negotiate a better arrangement with any other third party provider of similar services.

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[13] The ISG Agreement provides that any information that is provided to one SRO by another pursuant to the Agreement may not be disclosed to the non-regulatory areas of the receiving SRO.

[14] 69 Fed. Reg. 71234.

[15] *Id.*

[16] *Id.*

The end result of the foregoing could be that SROs that outsource their regulatory programs would be effectively required to disclose more details of their programs than SROs that do not. The Amex strongly believes that uniform disclosure should be required of each SRO, regardless of whether or not it outsources its regulation. In that regard, a preferable alternative might be to allow a description of the contract to be provided instead of a copy of the contract itself, with the level of required disclosure being equivalent to that of an SRO that does not outsource. Alternatively, the SRO filing a copy of its contract or agreement should be allowed to redact and keep confidential material information that non-outsourcing SROs are not required to provide. It is our understanding that the Commission has not previously allowed the public disclosure of outsourcing agreements (e.g., the ISE regulatory service contract with NASD), and we believe that the Commission should follow its prior practice in this area.

Based on these concerns, particularly as they relate to the details of regulatory developments at the Exchange, and in response to Question 147 posed by the Commission in the Release,[17] the Amex supports the adoption of a procedure like Rule 83 that would allow us to request confidential treatment for certain categories of the information that the Exchange will be required to submit as part of its quarterly and annual reports. Our expectation is that there will be ways to tailor that procedure for the disclosure proposed in the Release, but additional time will be needed develop this.

Finally, we wish to call the Commission's attention to the need to clarify the requirements of Item 6 of proposed Exhibit I to the registration statement, which call for a description of all material contracts and material related party transactions.[18] Read literally, the definition of "material contracts" in Item 6 seems to include only contracts that involve related parties (because the phrase "is also a party" seems to modify "material contracts" as well as "material related party transactions"). We are not certain if this is the intent and this point should be clarified.

Thank you for giving us the opportunity to express our views on these important proposed rules. If the Commission or members of its staff have questions concerning any matters raised in this letter, please contact me at (212) 306-2200.

Sincerely,

/s/ Neal Wolkoff

cc: The Hon. William Donaldson, Chairman
The Hon. Paul Atkins, Commissioner
The Hon. Roel Campos, Commissioner
The Hon. Cynthia Glassman, Commissioner
The Hon. Harvey Goldschmid, Commissioner

[17] 69 Fed. Reg. 71180.

[18] 69 Fed. Reg. 71249.

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