

RESPONSE
To The
Special Governance Committee of
The New York Stock Exchange

Submitted by: THE ALLIANCE OF FLOOR BROKERS
August 1, 2003

The Alliance of Floor Brokers welcomes this opportunity provided to it by the Special Committee of Governance on the New York Stock Exchange. As a prelude, the Alliance Board is a group that represents over 800 different individuals associated with the New York Stock Exchange. This group includes independent Floor brokers, specialists, commission house brokers and lessors. Our motto has been to represent the interests of all of those who wear the white badge and by extension, those owners who are behind them. Our goals have consistently been identical to those of the institution: enhancing the agency-auction market for the benefit of 85 million investors. We realize that by doing what is in those investors' best interests is always in our best interest.

Earlier this year, the New York Stock Exchange received a letter from William H. Donaldson, Chairman of the US Securities and Exchange Commission asked the NYSE, "To engage in a review of [NYSE] corporate governance practices, including board structure and representation, and oversight of management policies and practices to ensure that they serve the public view".¹ Over the decades there have been numerous opportunities for the New York Stock Exchange to re-examine itself. To help us prepare our presentation, we have reviewed all of the prior works beginning with the Committee for the Study of the Organization and Administration of the New York Stock Exchange from 1938 and continuing through the reports of McChesney Martin (1971), Roche (1980) and Barber (1985). This historical perspective has helped us as we attempt to aid this Special Governance Committee in its work. Furthermore, it became obvious to us that, on occasion, what was old has become new again.

¹ Letter from Chairman Donaldson to NYSE Chairman Richard Grasso dated March 26, 2003

Board Composition and Structure

One of the major topics that confront any group involved in the evaluation of the governance principles is the composition of the Board of Directors. When looking closely at the board of any company or institution, the fundamental question that one must ask is: whom does the board represent? In the case of the NYSE, the answer is inherently more complicated than that in a traditional public company. In addition to our aforementioned 85 million investors, we also have the owners, the participants – both from the buy and sell sides- the public, the listed companies and finally, NYSE management. While most, if not all of these groups are and have been represented on the board, it is incumbent upon us to ensure that “The Board of the Exchange embodies a “legislative” model of checks and balances among constituent representatives”.² It is the opinion of the AFB that our exchange must continue to embrace all those that we currently do and seriously consider others that should be as deserving a seat at the table.

First of all, the terminology has been flawed when describing board representation. There are clearly “industry” and “non-industry” as well as those who are the representatives of the “public”. First, let us focus on the industry representation. Those who represent the industry on the board must be comprised of specialist and agent floor members of the NYSE as well as a diverse mix of large, regional and specialty member firms. Though there is diversity of opinion amongst our representative board, the number of people who represent the vital Floor constituency groups must be evaluated. The fact that the agency business on the Floor of the NYSE has continued to grow as more customers bring their order directly to the point-of-sale as well as the contraction of the number of specialist units must be weighed as we struggle with the

² Governance of the New York Stock Exchange, Inc. White Paper dated May 2003 page 2

composition of our Board. Moreover, the member firms that are important participants in our marketplace must certainly be afforded that chance to opine from seats on the Board. The Alliance of Floor Brokers will not charge this committee with a definitive structure as to how these vital industry groups should be represented going forward. However, it is clear that the New York Stock Exchange Floor and the major sell-side order delivery firms must continue to be afforded significant representation on the Board.

With the severe consolidation that we have seen in the securities industry over the last few years, some serious issues of potential double Board representation have arisen. A publicly traded firm could see its Chief Executive Officer nominated for the board while its principal subsidiary's CEO may serve as an industry director. Potentially, as was the case with a director who was nominated this spring but withdrew before election, a specialist subsidiary of a large member firm could have its CEO qualify for board seat while the parent's CEO also serves. These situations cannot be allowed to happen. While this problem is most notably found amongst the industry group, there is increasing potential for it to happen in the future (under our current rules) with the continued growth of financial supermarkets and banks with broker-dealer subsidiaries. The Special Governance Committee must focus on this issue as they strive to provide the broadest base of representative directors within the confines of a limited number of seats. Further, the charge to the nominating committee must be clear that representatives for the Board must never be nominated when a situation of double representation is or could be present.

The final pieces of the industry puzzle are those owners who do not work on the Floor. We place these individuals in the "industry" group though their association is not direct with the day-to-day operations of the NYSE. However, their interests (and

income) most clearly are. The committee must strongly consider the right of owners to be represented on the Board as a constituent group.

One of the challenges that the NYSE and this committee has and will deal with is the question of the definition of “public”. In the language of NYSE, public meant “non-industry” but over time, blind spots in that understanding and articulation have begun to appear. The board of the AFB supports a definition of public that would indicate someone who is truly unconflicted in their relationship to the NYSE. These individuals may come from academia, be public officials, those retired from senior executive positions at major (listed) companies or “be significant investors in equity securities”.³ It is this last group that the Alliance of Floor Brokers feels most strongly about their significant participation on the Board of the NYSE. Representatives of the institutional investment community (to be clear, **the buy-side**) who bring their orders to the NYSE and allow us the privilege of executing those orders on behalf of the 85 million investors that they serve should be well represented as we shape the shape the policies, write the rules and set the agenda for competition in the ever changing financial landscape.

Independent Nominating Committee

Another source of great debates among the governance gurus today are the independence of the Board committees. Can they perform their duties without undue influence from a company’s management? Are there relationships, business or otherwise, between Board members? Between the Board, Management and the Nominating Committee? In most cases, there is not nor has there ever been any problem.

³ language taken from the NYSE Constitution Article IV Section 2 (ii)

However, the problem does not just lie in the reality but in the perception. Currently, the Nominating Committee is comprised of four industry representatives and four public directors.⁴ This group, after their service to the Exchange in this regard has ended, nominate their own successors. This creates the impression of a self-perpetuating nature in this group that could possibly give rise to criticism in terms of its independence as well as its ability to cultivate new candidates for the Board. Furthermore, interlocking relationships between Board members, the members of the Nominating Committee and those persons who are eventually nominated must be prohibited.

Dialogue with management is clearly vital to this process but, for the sake of transparency, might we suggest that those meetings be permitted only during the public sessions?

The Chairman and not Chief Executive Officer

More and more in corporate America today do we see the roles and responsibilities of the Chairman of the Board and the Chief Executive Officer not vested in the same individual. Our Exchange forefathers envisioned these dual roles as early as the 1938 when they suggested in their final report that the Chairman of the Board “should be an outstanding member of the Exchange and should be elected each year by the membership”.⁵ The McChesney Martin Report from 1971 identified the need (which still exists today) for full time and professional management of the NYSE. To clearly split the responsibilities between these two vital roles, one would only have to look to the Constitution of the NYSE, Article VI Section 2. Rewritten, the document would say:

⁴ Article V, New York Stock Exchange Constitution Section 1 (a) and (b)

⁵ Final Report of the Committee for the Study of the Organization and Administration of the New York Stock Exchange January 27, 1938 page 2

The Chairman of the Board shall be the presiding officer of the Board and an *ex officio* member of all committees authorized by the Board. The chief executive officer of the Exchange will be responsible for the management and administration of its affairs and shall share, with the Chairman, the role of officially representing the Exchange in all public matters. The Chairman would be a member of the Exchange.

The Alliance of Floor Brokers would also like to make perfectly clear that our remarks in this area should not be construed as a reflection of the high opinion in which we hold our current Chairman and CEO as he fulfills these dual roles. But, as our Founding Fathers knew, you cannot design an office such as the Presidency assuming it would always be filled by the likes of Washington, Adams and Jefferson.

Communication

Our current review of the Exchange's corporate governance is similar to examinations that are proceeding throughout corporate America. Moreover, these reviews come on the heels of one of the most significant changes that have occurred among public companies for many decades. Regulation F-D ("fair disclosure") has been the rallying cry of the small investor and the challenge of the public company for the past few years. Hand in hand with good corporate governance is the necessity to communicate effectively with your shareholders and constituent groups. The Exchange has over the years sought to do this in a variety of different ways. Most effective have been the "town hall" general membership meetings that have been held several times a year. The Alliance believes that codifying these meetings, adding features for remote access and enhancing communication directly with the Board are necessary. First of all,

the general membership meetings with the Chairman and the Chief Executive Officer (both present) should be held on the Tuesday following a Board meeting after the close. Moreover, for those who cannot attend in person or are geographically disenfranchised, we would suggest the use of a Webcast, similar to what is done throughout corporate America. Finally, the AFB would propose that a meeting between the entire NYSE Board and the seat holders be held semi-annually. This can only make the Board more knowledgeable and informed.

Interim Governance Principles

After a careful analysis of the Interim Governance Principles that were adopted by the NYSE Board on June 5th, The Alliance of Floor Brokers would like to offer the Special Committee on Governance our observations. Overall, we agree with the concepts that are stated by these principles but in order to provide the most inclusive Board structure, allow for the most educated directors and foster the most communication between all parties, we offer the following comments.

The AFB acknowledges that it is vital for the NYSE to speak with one voice. Numerous constituent interests must be brought to the board table but only one final decision on each issue can possibly be implemented. Management is entrusted with the responsibility of communicating those Board decisions with each unique group within the institution, regulators and the public. With this in mind though, it is important for each individual Board member to gather as much information about each and every issue before that final determination. Yet there appears to be a contradiction within the “principles”. There is allusion to the fact that Board members “will meet regularly in

executive session”.⁶ Additionally, the final paragraph of the second principle, Directors Responsibilities, allows Board members to speak to “various constituencies that are involved with the NYSE... only at the request of management.”⁷ As directors of the institution, the Board members should be encouraged to speak freely with anyone who can help them to reach the correct decision on issues that are or may come before the Board. Actually, with this change, the Board principles become much more aligned since the fourth principle of “Director Access to Officers and Employees” offers and encourages unfettered communication.

One area of some concern to the Alliance of Floor Brokers is contained in principle number six. We applaud the NYSE for providing our new directors with an Orientation Program conducted shortly after their election to the Board. Knowledge of the duties and responsibilities of being a director of the NYSE is important for the effective functioning of our Board. The Board members do need to learn about the “strategic plans, [NYSE’s] significant financial, accounting and risk management issues, its self-regulatory responsibilities...”⁸ as well as to meet with management. Unfortunately, as the principles are currently written, the Directors never have to visit the Floor of the NYSE. Part of the new Orientation Program should be to spend time with floor brokers and specialists in order to learn first hand the value that these groups provide to the investment community each and every day. Furthermore, it will be difficult for directors of the institution to render a fully informed decision on a matter that comes before the Board without the vital knowledge that they would accrue during their educational exchange with agents and dealers. With this in mind, the AFB believes that

⁶ Interim Governance Principles, As Adopted by the Board of Directors on June 5, 2003 page 2

⁷ emphasis added

⁸ Interim Governance Principles, As Adopted by the Board of Directors on June 5, 2003 page 3

it is absolutely essential that each new director spend a significant amount of time (at least an entire day) on the Floor of the NYSE with floor brokers and specialists. This time would be coordinated through the Chairman but the Board members would be free to learn at their own pace during that time without management intervention.

In order to summarize this, the formal part of our presentation, we would like to review several key points.

The New York Stock Exchange is a truly unique institution. It has a broader and more diverse list of constituents than that of any other, save, perhaps, the government itself.

Over the last 70 years its shareholders, the members, have repeatedly reviewed its structure and reorganized in an effort to make it more responsive, responsible and transparent. In that effort they have invited more and different groups to the governing table. As we renew that exercise here, we must remember the three general categories discussed: the brokerage/financial industry, corporate (which would include both listed companies and institutional investors) and last but certainly not least, the public.

We endorse codifying and enhancing the independent nature of the Nominating Committee. We suggest restriction of multiple Board representation of a single entity through a subsidiary or other relationship. We suggest consideration of separating the role of Chairman and Chief Executive Officer as is being considered at many of our

client companies. We believe communication between the Exchange and all of its constituencies should be mandated to be both open and frequent.

The Alliance of Floor Brokers appreciates the time and dedication of the Special Committee on Governance in helping the New York Stock Exchange to assess and address its needs. The AFB appreciates this opportunity to share its thoughts with the committee as well as to engage the committee in an ongoing dialogue as the process continues. We stand ready to assist you in any manner as your work proceeds.

We are available for any questions or clarifications the committee would like to address.