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On

“Consolidation of NASD and the Regulatory Functions
of the NYSE: Working Towards Improved Regulation”

Subcommittee on Securities, Insurance
and Investment

Committee on Banking, Housing and Urban Affairs
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I. Introduction

Chairman Reed, Senator Allard, and distinguished Members of the Subcommittee, I am Richard G. Ketchum, Chief Executive Officer of NYSE Regulation. NYSE Regulation, Inc., is a not-for-profit subsidiary of NYSE Euronext, dedicated to strengthening market integrity and investor protection.

I want to thank the Subcommittee for providing this opportunity to address how the impending consolidation of NYSE Regulation's member regulation functions and NASD will impact the securities industry and investors.

For decades there have been multiple self-regulatory organizations ("SROs") with the responsibility to oversee the largest broker-dealers in the United States. To protect investors and ensure confidence in our securities markets, the SROs were, in effect, deputized to work on the front lines of America's capital markets under the supervision of the U.S. Securities and Exchange Commission (SEC). The SROs' mandate is to ensure that there is a fair and level playing field for all investors.

NYSE Regulation has played a significant role in the oversight of our nation's largest brokerage firms. Our 400 member firms maintain 98 million customer accounts, or 84 percent of the total public customer accounts handled by broker-dealers, with total assets of over \$5 trillion. They operate from 20,000 branch offices around the world and employ 197,000 registered personnel. NYSE Regulation has served a vital role in policing this market.

Our Market Surveillance division monitors trading activities on the Floor and trading "upstairs" by member firms. The division also investigates trading abuses, including insider trading and market manipulation. Using sophisticated technology and

pattern recognition systems, the staff detects and investigates activity that may violate NYSE rules or federal securities laws, and recommends cases for prosecution to the NYSE Regulation Enforcement division or the SEC, depending upon jurisdiction.

Our Member Firm Regulation (MFR) division protects investors through regular and for-cause on-site examinations of NYSE member firms. These examinations are designed to review each firm's financial integrity, operational stability, timeliness and accuracy of books and records, compliance with customer protection rules, and sales practice compliance programs. MFR establishes guidelines to identify firms approaching financial or operational difficulties and to anticipate the erosion of capital due to losses, potential capital withdrawals, and changes to regulatory capital requirements.

NYSE Enforcement investigates and prosecutes violators of NYSE rules and the federal securities laws. Enforcement cases stem from a variety of sources, including referrals from NYSE Member Firm Regulation and NYSE Market Surveillance, as well as investor complaints made directly to the NYSE, required filings by member firms, and referrals from the SEC.

Through our Listed Company Compliance division, NYSE Regulation ensures that companies listed on NYSE and on NYSE Arca meet their financial and corporate governance listing standards. To maintain the quality of our list, listed companies are required to meet original listing criteria and maintain continued listing standards that, on the NYSE, are among the highest of any market in the world.

Arbitration at the Exchange dates back to 1817 and has served as an effective alternative forum to the courts. Our Arbitration Unit's effectiveness is based on the facts that it is efficient, convenient, quicker, and less expensive than legal proceedings.

II. Recent Changes

Three years ago, I accepted an offer to serve as the New York Stock Exchange's first fully independent chief regulatory officer. The creation of my position was part of sweeping corporate governance reforms that were launched after the independence of regulation at the NYSE had been severely questioned. A new structure was created that explicitly separated market operations from regulation, strengthened the independence of regulatory decision-making, and established a governance structure in which the chief regulatory officer reported not to the New York Stock Exchange's chief executive officer—as previously had been the case—but rather directly to the Regulatory Oversight Committee of the NYSE's board of directors.

New regulatory management was recruited. Our investment in technology was increased to efficiently improve oversight of the activity of member firms and trading on the Floor of the Exchange. We began leveraging technology to assist us in performing risk-based examinations of our member firms in both sales practice and financial and operational areas. Enforcement actions grew in size and sophistication. A Risk Assessment Unit was created to enhance the protection of the investing public and increase NYSE Regulation's effectiveness by identifying and responding to emerging trends or practices that may compromise investor protection.

While the new governance structure of NYSE Regulation worked well, new developments required further steps. In April 2006, the merger of the New York Stock Exchange and the Archipelago Exchange was completed and the NYSE Group became a public company. As a public company with a fundamental responsibility to maximize shareholder value, it became important to further formalize the organizational separation

that had been created between the market and regulation and provide for full legal separation. As a result, NYSE Regulation was organized as a separate not-for-profit corporation, wholly owned by the NYSE Group but with its own majority independent board of directors.

While we successfully addressed conflict concerns, our experience demonstrated that if self-regulation is to maintain its central role in the increasingly complex financial industry, we also needed to eliminate needless duplication from our rules, our examination programs, as well as in our enforcement investigations.

I believe strongly in the value of self-regulation. In simplest terms, self-regulation offers the benefit of greater expertise, the capacity to leverage government resources, and the ability to impose ethical standards that would be inappropriately compelled by a governmental entity. But self-regulation must be carried out efficiently for the benefit of all involved parties—including the securities industry, capital markets, and investors. This, of course, includes eliminating inconsistent or duplicative rules that impose unfounded financial burdens.

In the past three years, working with NASD, we have achieved significant results in reducing regulatory duplication of brokerage firms that are members of both of our respective organizations. A Memorandum of Understanding with NASD assured firms that if they requested a joint oversight exam, rather than separate visitations, they would get it. Moreover, we began coordinating sweeps or targeted examinations with NASD and the SEC.

For more than a year, we have worked with NASD and representatives of the securities industry on an ambitious program to harmonize our rules. We have identified

unjustifiable differences between NYSE and NASD rules and interpretations, proposed a program of revisions. I am pleased to report that we have made very substantial progress in this initiative.

III. Regulatory Merger

But soon it became apparent that we could do even more. That recognition led the New York Stock Exchange and NASD to announce last November that we would combine our member-related regulatory functions into a new regulatory organization—the first major reform of the self-regulatory system in 73 years. Clearly, it is an idea whose time has come.

I will serve as chairman of the board of the new organization, while also continuing on as chief executive officer of NYSE Regulation. Mary Schapiro, NASD's current chairman and chief executive officer, will run the new organization as CEO. I look forward to working with Mary, who I have known for more than 25 years. She is a strong regulator and a great professional.

The new SRO will operate from Washington D.C., New York City, and district offices throughout the US. Approximately 470 of NYSE Regulation staff in member regulation, arbitration, risk assessment, and related enforcement units will join the new organization.

Going forward, NYSE Regulation will be focused on areas where its unique market expertise is critical to effective regulatory oversight. Specifically, we will continue to be responsible for conducting market surveillance and routine disciplinary actions, as well as ensuring that companies listed on NYSE and NYSE Arca meet their financial and corporate governance listing standards.

IV. Benefits of the Merger

Our joint proposal with NASD is to create a single, new self-regulatory organization that will be the private-sector member regulator for all securities brokers and dealers that do business with the public in the United States. Under the strong oversight of the SEC, self-regulation will continue to play a vital role in the U.S. capital markets. Ultimately, there will be a single set of rules, most likely tiered for firms of different sizes. There will be one set of examiners and one enforcement staff.

The goal for both organizations is to reduce burdens on firms that have received multiple visits by different sets of examiners, while increasing the ability to protect investors by using exam resources in the most efficient and effective way. The resulting efficiencies should allow the firms to be more efficient, and to be able to serve their customers at lower cost.

The combined staff will have more time to ferret out wrongdoing when freed from the task of coordination or interpretation of inconsistent rules. Regulatory arbitrage will also be a thing of the past. Firms will no longer be able to take advantage of subtle differences in rules and exploit different interpretations by the staff of the two SROs. This will be a direct benefit to investors.

In February 2007, we filed with the SEC a report detailing the results of our Rule Harmonization project. If approved by the Commission, the rule proposals will substantially conform NYSE rules to those of NASD. In certain instances, the industry committees that were part of the process recommended that NASD adopt the NYSE rule. In other instances, we have chosen the best of both regulators' rules and expect the dialogue to continue as the new organization works toward a single rulebook.

In the interim, the new SRO will adopt all existing NYSE rules applicable to NYSE member firms. We are encouraged that the SEC has indicated that they will fast track certain proposed amendments to our rules that in all likelihood eliminate different standards on day one of the merger.

While these are important steps, the new, combined regulator will have as one of its highest priorities the creation of a single rulebook. As chairman of the new organization, I look forward to seeing this project through to its conclusion.

As for the merger, in addition to uniting rulebooks, NYSE Regulation and NASD are working closely together in several Integration Teams. One such team is combining the examination programs of both SROs. The goal is to have one integrated Financial/Operational and Sales Practice Program for 2008. Much progress has been made, proof of the commitment by both SROs to the ideals behind the consolidation. At the same time, both SROs are working together to complete their respective examinations for 2007 by working together to avoid any regulatory duplication.

Importantly, NYSE Regulation will continue to play a vital role, both in overseeing the trading on the NYSE markets and in NYSE-listed securities, and in assuring the regulatory integrity of our listing programs. These activities do not present the issue of regulatory duplication that we confront in member firm regulation. In addition, they are activities that are best performed by NYSE Regulation, so that regulatory systems and processes can be developed and improved in real time and in close coordination with changes in the trading systems or rules or listing requirements. Our ability to effectively regulate these important activities is significantly enhanced by

our continuing to do these activities in the independent, yet connected, entity that is NYSE Regulation.

V. Conclusion

I feel honored to have been a part of the revitalized NYSE Regulation at a time of incredible change. But this new self-regulatory organization for member firm regulation is an idea whose time has come. U.S. investors will continue to have a regulator that has the resources and skills to keep pace with an increasingly complex, global and changing securities industry. Our member firms deserve the most efficient regulatory structure possible based on a single rulebook and one consolidated examination and enforcement program. By combining the enormously talented staffs of NYSE Regulation and NASD, we will be able to meet the challenges of tomorrow.