

TESTIMONY OF KIM BANG
PRESIDENT AND CHIEF EXECUTIVE OFFICER
BLOOMBERG TRADEBOOK LLC
BEFORE THE SENATE COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
REGARDING
“REGULATION NMS (NATIONAL MARKET SYSTEM) AND
DEVELOPMENTS IN MARKET STRUCTURE”

JULY 22, 2004

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE. MY NAME IS KIM BANG, AND I AM PLEASED TO TESTIFY ON BEHALF OF BLOOMBERG TRADEBOOK REGARDING “REGULATION NMS AND DEVELOPMENTS IN MARKET STRUCTURE”. THE TOPIC IS BOTH IMPORTANT AND TIMELY.

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PUBLISHES MAGAZINES AND BOOKS ON FINANCIAL SUBJECTS FOR THE INVESTMENT PROFESSIONAL AND NON-PROFESSIONAL READER.

BLOOMBERG TRADEBOOK IS A GLOBAL ELECTRONIC AGENCY BROKER SERVING INSTITUTIONS AND OTHER BROKER-DEALERS. WE COUNT AMONG OUR CLIENTS MANY OF THE NATION'S LARGEST INSTITUTIONAL INVESTORS REPRESENTING — THROUGH PENSION FUNDS, MUTUAL FUNDS AND OTHER VEHICLES — THE SAVINGS OF MILLIONS OF ORDINARY AMERICANS.

BLOOMBERG TRADEBOOK SPECIALIZES IN CONSOLIDATING WHAT HAS BEEN A FRAGMENTED MARKET BY INCREASING TRANSPARENCY AND ACCESS TO LIQUIDITY. OUR CLIENTS HAVE REWARDED OUR CREATIVITY AND OUR SERVICE BY TRUSTING US WITH THEIR BUSINESS, ENABLING US TO REGULARLY TRADE MORE THAN 150 MILLION SHARES A DAY.

I. THE UNDERLYING ISSUE DRIVING REG NMS IS THE NEAR MONOPOLY THE NYSE ENJOYS OVER THE TRADING VOLUME IN ITS LISTED SECURITIES

THE SENATE BANKING COMMITTEE HAS LONG UNDERSTOOD HOW SEEMINGLY ABSTRACT MARKET STRUCTURE ISSUES HAVE A DIRECT BEARING ON THE EFFICIENCY AND COMPETITIVENESS OF OUR MARKETS AND THE INTERESTS OF INVESTORS. THE COMMITTEE'S INTEREST IN THE SEC'S REGULATION NMS PROPOSAL IS WELCOME AND WARRANTED.

PROPOSED REGULATION NMS IS AN AMBITIOUS EFFORT TO ENGAGE POLICY MAKERS, MARKET PARTICIPANTS AND THE PUBLIC IN A DEBATE OVER HOW BEST TO PROMOTE THE LONG OVERDUE MODERNIZATION OF THE U.S. EQUITY MARKETS.

MARKET PARTICIPANTS AND POLICY MAKERS HAVE OFTEN ASKED “WHY DOES THE NYSE CONTROL 80 PERCENT OF THE TRADING VOLUME OF ITS LISTED COMPANIES WHEN NASDAQ CONTROLS ONLY ABOUT 20 PERCENT OF THE VOLUME OF ITS LISTED COMPANIES?” THE ANSWER IS SIMPLE — REGULATORY BARRIERS TO COMPETITION.

II. THE OTC MARKET AS A MODEL FOR A COMPETITIVE MARKET

THE NASDAQ MARKET SINCE 1996 PRESENTS THE OPPOSITE PICTURE — IT IS A MARKET INTO WHICH REGULATION INTRODUCED AND ENCOURAGED COMPETITION. THE NASDAQ PRICE-FIXING SCANDAL OF THE MID-1990S RESULTED IN THE SEC’S 1996 ISSUANCE OF THE ORDER-HANDLING RULES. THOSE RULES ENHANCED TRANSPARENCY AND COMPETITION IN THE NASDAQ MARKET AND PERMITTED ELECTRONIC COMMUNICATIONS NETWORKS — ECNS — TO COMPETE FOR ORDER FLOW, BENEFITING INVESTORS AND ENHANCING THE QUALITY OF THE MARKET.

INDEED, THE INCREASED TRANSPARENCY PROMOTED BY THE SEC’S ORDER-HANDLING RULES AND THE SUBSEQUENT INTEGRATION OF ECNS

INTO THE NATIONAL QUOTATION MONTAGE NARROWED NASDAQ SPREADS BY NEARLY 30% IN THE FIRST YEAR FOLLOWING ADOPTION OF THE ORDER-HANDLING RULES. THESE, AND SUBSEQUENT REDUCTIONS IN TRANSACTIONAL COSTS, CONSTITUTE SIGNIFICANT SAVINGS THAT ARE NOW AVAILABLE FOR INVESTMENT THAT FUELS BUSINESS EXPANSION AND JOB CREATION.

THE QUESTION CONFRONTING THE SEC AND THE CONGRESS IS WHETHER OUR MARKETS IN LISTED SECURITIES CAN BE REFORMED TO BRING THE SAME BENEFITS TO THE NYSE INVESTOR AS THEY HAVE TO THE NASDAQ INVESTOR. NOW THAT THE NYSE HAS BEEN FORCED TO GIVE UP ITS RULE 390 (RESTRICTING ORDER FLOW TO THE OTC MARKET) AND RULE 500 (RESTRICTING THE ABILITY OF LISTED COMPANIES TO DELIST), THE EXISTING TRADE-THROUGH RULE REMAINS THE FOREMOST IMPEDIMENT TO THAT REFORM.

III. THE TRADE-THROUGH RULE IS PROTECTIONIST REGULATION

THE TWENTY-YEAR-OLD TRADE-THROUGH PROVISION OF THE INTER-MARKET TRADING SYSTEM PLAN STATES THAT WHEN THE SPECIALIST OR MARKET MAKER RECEIVES AN ORDER, IT CANNOT EXECUTE IT AT A PRICE INFERIOR TO ANY FOUND ON ANOTHER MARKET WITHOUT GIVING A “FILL” TO THE BETTER-PRICED ORDER. BUT THERE IS A GAP BETWEEN THE RULE’S PRINCIPLE AND ITS PRACTICE. UNDER THE

RULE, ORDERS ARE NOT PROTECTED SO MUCH AS THEY ARE HELD HOSTAGE.

CONSIDER, FOR EXAMPLE, THE AMERICAN STOCK EXCHANGE. BLOOMBERG TRADEBOOK DOESN'T SEND ORDERS IN NASDAQ STOCKS TO THE AMEX EVEN THOUGH THEY ARE TRADED THERE. IT TAKES AT LEAST 10 TO 15 SECONDS BEFORE WE GET A RESPONSE FROM THE AMEX. THAT IS JUST TOO SLOW. IN TODAY'S ELECTRONIC MARKETS, IN WHICH MARKETS MOVE IN MILLISECONDS, A DELAY OF 10 TO 15 SECONDS IS AN ETERNITY. WE FACE THE SAME PROBLEM WITH THE NYSE WHEN IT DISPLAYS THE BEST PRICE. AN ORDER SENT TO NYSE IS ROUTINELY DELAYED FOR 22 SECONDS WHILE THE SPECIALIST DECIDES WHETHER TO EXPOSE THE ORDER TO THE TRADING FLOOR FOR PRICE IMPROVEMENT. IN THE MEANTIME, THE MARKET MOVES. AND THE WAIT FOR PRICE IMPROVEMENT, IF ANY, IS A LOST OPPORTUNITY INVESTORS CAN ILL AFFORD. THE CLEAR DISADVANTAGE TO INVESTORS IS NOT ONLY IN HAVING THEIR ORDERS HELD UP ON AMEX OR THE NYSE, BUT ALSO IN BEING DEPRIVED OF PRICING OPPORTUNITIES REPRESENTED IN OTHER MARKETS.

IV. THE TRADE-THROUGH RULE DOES NOT PROTECT LIMIT ORDERS

CURRENTLY, THE INTERMARKET TRADING SYSTEM TRADE-THROUGH RULE PROTECTS INEFFICIENT MARKETS BY MANDATING THAT INVESTORS PURSUE THE ADVERTISED THEORETICAL "BEST PRICE"

INSTEAD OF THE BEST AVAILABLE FIRM — IMMEDIATELY EXECUTABLE —
PRICE.

BOTH THE EXISTING RULE — AND THE SEC’S PROPOSED RULE —
FAIL TO PROTECT LIMIT ORDERS IN AT LEAST THREE WAYS:

1. THEY DO NOT ACCORD TIME PRIORITY TO LIMIT ORDERS THAT HAVE ALREADY BEEN PLACED — EVEN LIMIT ORDERS PLACED ON THE NYSE. THAT IS LIKE A RESTAURANT WHERE YOU STAND PATIENTLY IN LINE FOR A TABLE BUT YOU HAVE NO PRIORITY OVER PATRONS WHO COME IN AFTER YOU DO. IN THE SECURITIES MARKETS, IN ADDITION TO BEING ANNOYING, THERE IS AN ECONOMIC COST. NOT HAVING TIME PRIORITY DENIES LIMIT ORDER ENTRANTS THE REWARD THEY SHOULD GET FOR, IN EFFECT, HAVING GRANTED THE MARKET FREE “OPTIONS” (PUTS IN THE CASE OF A LIMIT ORDER TO BUY, CALLS IN THE CASE OF A LIMIT ORDER TO SELL).

2. ALSO, THERE IS NO INTERMARKET TIME PRIORITY. THE TRADE-THROUGH RULES PERMIT ANOTHER MARKET CENTER TO “MATCH” PRE-EXISTING LIMIT ORDERS ENTERED IN ANOTHER MARKET. THAT PERMITS EXCHANGES SUCH AS THE NYSE TO MATCH AND THEN INTERNALIZE ORDERS RATHER THAN TO SHIP THEM TO OTHER MARKET CENTERS OFFERING BETTER PRICES — AGAIN THE LIMIT ORDER ENTRANT IS DENIED A REWARD.

3. LIMIT ORDERS ARE NOT PROTECTED AGAINST “PENNYING” — BY WHICH NYSE SPECIALISTS AND OTHER FLOOR MEMBERS JUMP AHEAD OF ORDERS BY TRIVIAL AMOUNTS — A PENNY OR TWO. THIS IS ONE OF THE NEGATIVE FALLOUTS OF THE MOVE TO DECIMAL MARKETS.

V. **A TRADE-THROUGH RULE: PROTECTING INVESTORS OR PROTECTING THE NYSE FLOOR?**

WE SHARE WITH SINCERE PROPONENTS OF TRADE-THROUGH RULES A VISION OF A NATIONAL MARKET SYSTEM THAT PROMOTES ORDER INTERACTION AND TREATS ALL ORDERS AND ALL INVESTORS FAIRLY. WE EMBRACE WHOLEHEARTEDLY A MARKET STRUCTURE THAT PROTECTS ALL PARTICIPANTS, LARGE AND SMALL. WERE A TRADE-THROUGH RULE EFFECTIVE AND NECESSARY TO ACHIEVE THESE ENDS, WE WOULD SUPPORT IT WITHOUT RESERVATION.

THE REALITY, HOWEVER, IS THAT THE EXISTING TRADE-THROUGH RULE DOES NOT PROVIDE ANY MEANINGFUL INVESTOR PROTECTION. IT IS, INSTEAD, AN IMPEDIMENT TO ACHIEVING BEST EXECUTION. IT HAS STOOD IN THE WAY OF INNOVATIVE TECHNOLOGY AND COMPETITION AND HAS DETERRED INVESTORS FROM OBTAINING DIRECT ACCESS TO MARKET DATA AND LIQUIDITY. AS ARCHIPELAGO’S GERALD PUTNAM HAS TESTIFIED:

EMPIRICAL DATA SHOWS THAT THE NYSE TROTS OUT THE TRADE THROUGH RULE WHEN IT SUITS ITS COMPETITIVE PURPOSES, BUT

IGNORES IT WHEN IT DOES NOT. HERE ARE SOME FACTS: ARCAEX RUNS SOFTWARE (APPLY NAMED 'WHINER') THAT MESSAGES ALERTS WHEN EXCHANGES TRADE THROUGH AN ARCAEX QUOTE IN VIOLATION OF THE ITS PLAN. THE WHINER DATABASE REFLECTS THAT ARCAEX CUSTOMERS SUFFERED UP TO 7,500 TRADE-THROUGH VIOLATIONS IN A SINGLE WEEK BY THE NYSE. IN FACT, TRADE-THROUGH VIOLATIONS HAVE ACTUALLY RISEN MOST RECENTLY DESPITE THE GLARE OF THE REGULATORY SPOTLIGHT ON THE NYSE. SINCE JUST THIS LAST . . . FALL (2003), THE ANNUALIZED COST TO INVESTORS OF THE NYSE SPECIALISTS TRADING THROUGH ARCAEX'S QUOTES HAS INCREASED 3-FOLD FROM APPROXIMATELY \$1.5 MILLION TO \$5 MILLION. ON ANY GIVEN DAY, ARCAEX HAS A BILLION SHARES ON OR NEAR THE NATIONAL BEST BID OR OFFER. YET ON ANY GIVEN DAY, THE NYSE SENDS ONLY 2 MILLION SHARES TO ARCAEX OVER ITS WHEN WE HAVE THE BEST PRICE.

WE HAVE CONFRONTED THE NYSE WITH OUR VOLUMINOUS DATA BUT TO NO AVAIL. IF, IN THE NYSE'S OWN WORDS, THE TRADE THROUGH RULE 'SERVES TO PROTECT INVESTORS,' THEN THE NYSE HAS SOME 'SPLAINING' TO DO AND NEEDS TO TAKE CORRECTIVE ACTION FORTHWITH TO ENFORCE AND COMPLY WITH THE TRADE THROUGH RULE IN ITS OWN MARKETPLACE.¹

THE TRADE-THROUGH RULE IN PRACTICE HAS BEEN A ONE-WAY STREET, WITH THE NYSE ITSELF AS THE HEAVY-HANDED TRAFFIC COP. TO BE SURE, THE NYSE GOES AFTER ITS OWN MEMBERS THAT TRADE

¹ Written statement of Gerald Dean Putnam, Chairman & Chief Operating Officer, Archipelago Holdings, L.L.C., concerning "Market Structure III: The Role of the Specialist in the Evolving Modern Marketplace" before Committee on Financial Services — Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, United States House of Representatives, 108th Cong., 2d Sess., February 20, 2004, at p. 6

THROUGH NYSE PRICES. NONETHELESS, THE NYSE'S SPECIALISTS ROUTINELY TRADE THROUGH BETTER PRICES ON OTHER MARKETS AND, AS A PRACTICAL MATTER, THEY DO SO WITH IMPUNITY. THEIR OWN ROUTINE VIOLATIONS OF THE TRADE-THROUGH RULE, WHICH TO OUR KNOWLEDGE HAVE NEVER BEEN THOROUGHLY INVESTIGATED OR PROSECUTED, HAVE SURELY COST INVESTORS MILLIONS OF DOLLARS.

FOR THEIR PART, THE REGIONAL MARKET CENTERS TEND TO COMPLY WITH THE CURRENT TRADE-THROUGH RULE WHILE AT THE SAME TIME THEY ARE NOT ABLE TO PROTECT THEIR CLIENT LIMIT ORDERS FROM BEING TRADED THROUGH BY THE PRIMARY MARKET. THEY ARE FURTHER DISADVANTAGED BECAUSE THEY ARE NOT PERMITTED TO EXECUTE INCOMING ORDERS ROUTED FOR EXECUTION AGAINST THEIR CUSTOMER LIMIT ORDERS WHEN THOSE ORDERS ARE DISPLAYED AND AVAILABLE, BUT AWAY FROM THE BEST QUOTED PRICES.

VI. WHAT HYBRID MARKET?

WE NOW READ PRESS REPORTS ABOUT A NEW MARKET WRINKLE THE NYSE IS DEVISING. THE ORIGINAL REG NMS PROPOSAL ENVISIONED A SYSTEM OF FAST AND SLOW MARKETS, THAT IS, AUTO-EXECUTION AND MANUAL MARKETS, AND PROPOSED AN OPT OUT THAT WOULD PERMIT "FAST" MARKETS TO TRADE THROUGH "SLOW" MARKETS WITHIN A SET RANGE OF INCREMENTS. IN RESPONSE, THE NYSE APPARENTLY HAS BEEN

CLOSETED WITH THE COMMISSION, DISCUSSING AN AS-YET-NONPUBLIC PROPOSAL FOR A MARKET THAT WOULD QUALIFY AS “FAST” BUT STILL PRESERVE THE MANUAL OPERATIONS THAT ARE AT THE CORE OF THE NYSE’S PROFITABILITY — AND ITS NEAR MONOPOLY.

IN ITS SUPPLEMENTAL RELEASE, THE COMMISSION HAS PROPOSED, AND THE NYSE HAS EMBRACED, REPLACING THE FAST VERSUS SLOW MARKET WITH FAST VERSUS SLOW QUOTATIONS AS THE BASIS FOR THE PROPOSED TRADE-THROUGH RULE. UNDER THE REVISED PROPOSAL, QUOTES WOULD BE DESIGNATED FAST OR SLOW AND FAST QUOTES COULD TRADE THROUGH SLOW QUOTES. THE RESULTING RULE, IF ADOPTED, WOULD NOT EXPOSE THE NYSE TO COMPETITION SO MUCH AS TO CONTINUE SHELTERING IT.

NEITHER WE NOR ANYONE ELSE IS PRIVY TO THE PRIVATE DISCUSSIONS BETWEEN THE COMMISSION AND THE NYSE, EVEN THOUGH THEY ARE CENTRAL TO THE SHAPE ANY FINAL NYSE RULE WILL TAKE AND THEREFORE ESSENTIAL TO INFORMED PUBLIC DISCUSSION AND DEBATE.

AN OUTCOME THAT WOULD ONCE AGAIN PROTECT THE NYSE FROM REAL COMPETITION FROM OUTSIDE WOULD BE AGAINST THE PUBLIC INTEREST AND WOULD NOT PROTECT INVESTORS. IF MANUAL MARKETS ARE TO CONTINUE TO BE A SIGNIFICANT PART OF OUR MARKET SYSTEM,

THEY MUST EARN THAT POSITION AS THE RESULT OF COMPETITION, NOT BECAUSE OF REGULATIONS THAT PROTECT THEM FROM COMPETITION.

WE SUSPECT FROM READING THE AARP'S RECENTLY PUBLISHED REPORT ON INVESTOR PREFERENCES THAT THE NYSE SOLD THE AARP A BILL OF GOODS. THE AARP BASED THE QUESTIONNAIRE USED IN ITS STUDY ON THE NOTION THAT THE 30-SECOND DELAY INVESTORS EXPERIENCE IN GETTING ORDERS EXECUTED ON THE NYSE IS DESIGNED "TO INCREASE THE CHANCE THAT THE BUYER OR SELLER WILL GET THE BEST POSSIBLE LISTED PRICE."

OF COURSE, PEOPLE IN THE KNOW UNDERSTAND THAT'S JUST NOT THE CASE. THE NYSE SLOWS DOWN EXECUTIONS TO GIVE ITS FLOOR MEMBERS A CHANCE TO TRADE ALONGSIDE INVESTORS' ORDERS AND TO KEEP EVERYONE NOT ON THE EXCHANGE FLOOR IN THE DARK AS TO WHAT IS GOING ON. THE NYSE'S STEALTH MARKET — WHICH IS THE ESSENCE OF THE PRIVILEGED TIME-AND-PLACE ADVANTAGES ITS FLOOR MEMBERS ENJOY — IS THE OPPOSITE OF TRANSPARENCY AND OPENNESS THAT AN INVESTOR-FRIENDLY MARKET WOULD PROVIDE. BY ASSUMING THAT INVESTORS BENEFIT FROM THE NYSE'S 30-SECOND DELAY, WHICH THE SEC IS PRESSURING THE NYSE TO GIVE UP, THE AARP DREW ITS MEMBERS TO A FALSE CONCLUSION. WE THINK ENTITIES LIKE CALPERS, CALSTERS, AMERITRADE, SCHWAB AND FIDELITY ARE CLOSER TO THE MARK AS TO WHERE THE INTERESTS OF SMALL INVESTORS RESIDE.

VII. THE MARKETS WOULD BE BETTER SERVED IF THE TRADE-THROUGH RULE WERE ELIMINATED

IN THE CASE OF NASDAQ-LISTED STOCKS, WE AT BLOOMBERG TRADEBOOK HAVE PLENTY OF PRACTICAL EXPERIENCE WITH HOW AND WHEN OUR CLIENTS CHOOSE TO TRADE THROUGH PUBLISHED PRICES. IN OUR EXPERIENCE, THE ONLY MARKET CENTERS OUR CLIENTS REGULARLY CHOOSE TO TRADE THROUGH OR AROUND ARE THE AMEX AND CERTAIN ECNS. OUR CLIENTS TRADE AROUND THE AMEX BECAUSE THE AMEX POSTS INDICATIVE QUOTATIONS AND IS SLOW TO RESPOND TO ORDERS. SOME OF OUR CLIENTS TRADE AROUND ONE OR TWO SMALLER ECNS THAT CHARGE EXORBITANT ACCESS FEES.

EXPERIENCE WITH NASDAQ PROVIDES CONVINCING EVIDENCE THAT A TRADE-THROUGH RULE IS NOT NECESSARY TO PROTECT INVESTORS. THE COMMISSION PROVIDES NO EVIDENCE IN SUPPORT OF EXTENDING A TRADE-THROUGH RULE TO THE OTC MARKET. THE PROPOSED RULE IS NOT ONLY UNNECESSARY, BUT ALSO WOULD IMPOSE SIGNIFICANT COSTS UPON THE MARKETS AND ULTIMATELY UPON INVESTORS. INDEED, THE COMMISSION'S OWN PRELIMINARY ESTIMATES OF THE SECURITIES INDUSTRY'S COSTS OF COMPLIANCE WITH THE PROPOSED TRADE-THROUGH RULE ARE EYE-POPPING. START-UP COSTS ARE PROJECTED TO EXCEED \$540 MILLION, WHILE ANNUAL, ONGOING COSTS OF COMPLIANCE ARE PROJECTED AT NEARLY \$224 MILLION.

THE NYSE HAS TRIED TO PERSUADE ITS LISTED COMPANIES THAT THEY BENEFIT FROM LOWER VOLATILITY. THE NYSE HAS ARGUED THAT VOLATILITY IS PERCEIVED TO BE GREATER IN NASDAQ-LISTED STOCKS THAN IN NYSE-LISTED STOCKS AND THAT THE ELIMINATION OF THE TRADE-THROUGH RULE WOULD INCREASE VOLATILITY.

I WOULD SUGGEST THAT THE GREATER VOLATILITY PERCEIVED IN THE NASDAQ MARKET, AS CONTRASTED WITH THE NYSE MARKET, MAY BE THE CONSEQUENCE OF NASDAQ'S NOT HAVING FLOOR MEMBERS TO DAMPEN VOLATILITY BY USING THEIR TIME-AND-PLACE ADVANTAGES TO JUMP AHEAD OF PUBLIC LIMIT ORDERS BY A PENNY OR JOINING LIMIT ORDERS ON BEHALF OF ORDERS THE FLOOR MEMBERS HOLD FOR OTHERS.

ONE QUESTION THAT SHOULD BE ASKED IN THAT REGARD IS WHETHER VOLATILITY *PER SE* IS GOOD OR BAD. IT MAY WELL BE THE CASE THAT SLOWING THE MARKET DOWN, AS A FLOOR-BASED SYSTEM DOES, DAMPENS VOLATILITY BECAUSE IT GIVES THE SPECIALIST THE OPPORTUNITY TO FIND THE OTHER SIDE, WHICH A FAST MARKET CANNOT AS READILY DO. ASSUMING THAT TO BE THE CASE, THE QUESTION IS WHETHER SLOWING THE MARKET DOWN IS APPROPRIATE AT ALL, EVEN IF IT DOES REDUCE VOLATILITY. IF GREATER VOLATILITY, WHICH MAY LOOK MORE SUBSTANTIAL IN A DECIMALIZED MARKET THAN IT DID IN AN EIGHTH-POINT OR SIXTEENTH-POINT MARKET, NATURALLY RESULTS IN A MARKET THAT IS NOT ARTIFICIALLY SLOWED

DOWN, THAT MAY BE AN ECONOMICALLY ACCEPTABLE OR EVEN BENEFICIAL RESULT.

WHAT THE NYSE REALLY IS UP TO IS PRESERVING INVESTOR COST, MEASURED BY THE PROFITS THE NYSE FLOOR MEMBERS EXTRACT FROM THE MARKET. THE PUBLIC PAYS A DEAR PRICE FOR THE NYSE SPECIALISTS' AFFIRMATIVE OBLIGATION, WHICH MAY WELL BE A CODE WORD FOR JUMPING AHEAD OF PUBLIC INVESTORS TO TAKE ADVANTAGE OF SUPERIOR MARKET INFORMATION KNOWN ONLY TO THOSE ON THE NYSE FLOOR. THE OPERATING RATIOS OF THE SPECIALISTS IN MOST YEARS IS EVIDENCE ENOUGH OF THEIR PRIVILEGED POSITIONS. THE MARKET, IF SUFFUSED WITH GREATER COMPETITION, WOULD QUICKLY ELIMINATE THESE EXCESSIVE RETURNS.

IF THE TRADE-THROUGH RULE WERE ABOLISHED FOR STOCKS LISTED ON THE NYSE, WE EXPECT OUR CLIENTS WOULD PREFERENCE THE FAST-MARKET VENUES (FIRM QUOTATIONS), BUT WOULD NOT IGNORE SLOW MARKETS (INDICATIVE QUOTATIONS) TO THE EXTENT THEY AFFORD AVAILABLE LIQUIDITY. FAST MARKETS WOULD AUTOMATICALLY EXECUTE AGAINST THEIR LIMIT ORDER BOOKS AND REFRESH THEIR QUOTATIONS IMMEDIATELY AND THEREBY EARN PROPORTIONATELY MORE ORDER FLOW OVER TIME. ORDERS RESIDING ON THE SLOW MARKETS BEYOND THE TOP-OF-FILE AND HIDDEN ORDERS IN THE CROWD WOULD BE TRADED THROUGH, AND RIGHTLY SO. IF THE

TRADE-THROUGH RULE WERE ELIMINATED, THE OPTION THAT SPECIALISTS CURRENTLY ENJOY, WHICH IS BOTH RISKLESS AND FREE, TO INTERCEPT INCOMING ORDERS, TO JUMP AHEAD BY A PENNY OR TO “GO ALONG” WITH INSTITUTIONAL ORDERS, WOULD BE DIMINISHED. SPECIALISTS WOULD THEN HAVE TO COMPETE ON A MORE EVEN BASIS WITH OTHER MARKET PARTICIPANTS TO SATISFY INVESTORS’ DEMANDS FOR BEST EXECUTION.

REMOVING THE TRADE-THROUGH RULE WOULD ALLOW INVESTORS TO CHOOSE THE MARKETS IN WHICH THEY WISH TO TRADE WHICH WOULD, IN TURN, PROMOTE COMPETITION AND BENEFIT INVESTORS. THE RESULTS WOULD BE GREATER TRANSPARENCY, GREATER EFFICIENCY, GREATER LIQUIDITY AND LESS INTERMEDIATION IN THE NATIONAL MARKET SYSTEM, WHICH ARE PRECISELY THE GOALS OF THE SECURITIES ACTS AMENDMENTS OF 1975.

THERE IS NO EMPIRICAL EVIDENCE TO SUGGEST THAT EXTENDING THE TRADE-THROUGH RULE TO NASDAQ SECURITIES IS NEEDED OR WOULD BE USEFUL. INDEED, IT MIGHT WELL GENERATE MANY OF THE ILLS THAT CURRENTLY AFFECT THE NYSE MARKET.

**VIII. THERE IS AN ALTERNATIVE — THE COMMISSION
COULD LAUNCH A PILOT PROGRAM EXEMPTING STOCKS FROM THE
EXISTING TRADE-THROUGH RULE**

THIS IS NO EVIDENCE TO SUPPORT THE IMPOSITION OF A TRADE THROUGH RULE. RATHER THAN INTRODUCING A COMPLEX AND EXPENSIVE NEW TRADE-THROUGH RULE THAT WOULD BE DIFFICULT TO ENFORCE, WE SUGGEST LAUNCHING A PILOT PROGRAM SIMILAR TO THE ETF *DE MINIMIS* EXEMPTION FROM THE TRADE THROUGH FOR A CROSS SECTION OF LISTED STOCKS, WITH NO TRADE-THROUGH RESTRICTIONS. THE COMMISSION COULD THEN MONITOR AND MEASURE THE RESULTS OF FREE COMPETITIVE FORCES.² IT WOULD DETERMINE WHETHER THERE IS A PROBLEM AND WHETHER A TRADE-THROUGH RULE WOULD ADDRESS THE PROBLEM.

SUCH A PROGRAM WOULD SIMPLY INVOLVE EXEMPTING A CLASS OF SECURITIES FROM THE EXISTING INTERMARKET TRADING SYSTEM TRADE-THROUGH RULE, TO SEE WHAT HAPPENS. THE STOCKS TO BE SELECTED COULD BE, FOR EXAMPLE, 200 OR 250 OF THE LISTED STOCKS IN THE S&P 500 STOCKS, AS IN THE COMMISSION'S REGULATION SHO PILOT PROGRAM, WHERE ONE THIRD OF THE RUSSELL 3,000 STOCKS ARE TO BE

² See Hendershott and Jones, "Trade-Through Prohibitions and Market Quality", unpublished working paper (April 8, 2004) at p.8, available at <http://faculty.haas.berkeley.edu/hender/> ("There is no evidence that market quality worsens when the trade-through rule is relaxed. In fact, overall effective spreads actually fall for all three ETFs, and the fall is statistically significant for DIA and QQQ.") The Commission would be able to monitor the execution quality from filings under Rule 11Ac1-5.

EXEMPTED FROM SHORT-SALE REGULATION. FRANKLY, PARTICULARLY GIVEN THE UNEVEN ENFORCEMENT OF THE EXISTING RULE, WE DOUBT GRANTING SUCH AN EXCEPTION WOULD DO ANYTHING MEASURABLE EXCEPT TO IMPROVE THE QUALITY OF THE MARKETS IN THOSE SECURITIES AS A RESULT OF SUBJECTING THE NYSE SPECIALISTS TO REAL COMPETITION IN THE AFFECTED SECURITIES. ALL THE NEGATIVE PROPHECIES SOME HAVE ADVANCED ABOUT THE ABSENCE OF A TRADE-THROUGH RULE WOULD BE TESTED AND, WE BELIEVE, EXPLODED.

IN ANY EVENT, PARTICULARLY GIVEN THE REMARKABLE ABSENCE OF ANY DEMONSTRATED PURPOSE OR NEED FOR THE MARKET-WIDE RULE THE COMMISSION HAS PROPOSED, A PILOT-PROGRAM EXEMPTION FOR 1,000 OF THE RUSSELL 3,000 STOCKS WOULD PROVIDE A REAL TEST CASE, ONE THAT WOULD DEMONSTRATE THE WISDOM OF WHAT MANY OF THE THOUGHTFUL COMMENTERS ON THE COMMISSION'S PROPOSAL ARE SAYING, THAT THE TRADE-THROUGH RULE PROVIDES ILLUSORY BENEFITS AND SHOULD BE RESCINDED, NOT EXPANDED.

IX. IF THERE IS TO BE A TRADE-THROUGH RULE, IT SHOULD APPLY ONLY TO IMMEDIATELY TOUCHABLE QUOTATIONS AND THERE SHOULD CONTINUE TO BE A BLOCK EXCEPTION

IF THE COMMISSION NEVERTHELESS CONTINUES TO PROCEED TOWARD ADOPTING A MARKET-WIDE TRADE-THROUGH RULE, THE RULE SHOULD APPLY ONLY TO QUOTATIONS THAT ARE IMMEDIATELY,

ELECTRONICALLY “TOUCHABLE”, THAT IS, ACCESSIBLE AND EXECUTABLE WITHOUT ANY DELAY AT ALL. QUOTATIONS THAT INVOLVE A DELAY IN EXECUTION, OR THAT CANNOT BE IMMEDIATELY ACCESSED AND TAKEN, WITH CONFIRMATION THAT A TRADE HAS OCCURRED BEING SIMULTANEOUSLY RELAYED TO THE ORDER ENTRANT, SHOULD NOT HAVE STANDING. THE NYSE AND THE AMEX MAY WISH TO CONTINUE THE OLD WAYS, BUT THOSE OLD WAYS SHOULD NO LONGER HOLD ANYONE OR ANY ORDER HOSTAGE.

IF THE COMMISSION ADOPTS A MARKET-WIDE TRADE-THROUGH RULE, IT SHOULD NOT ADOPT THE OPT OUT PROVISIONS IT PROPOSED BUT SHOULD SIMPLY RETAIN THE EXISTING BLOCK EXCEPTION IN THE INTERMARKET TRADING SYSTEM RULE.³ THE BLOCK EXCEPTION HAS BEEN AROUND FOR A LONG TIME. THE SKY HAS NOT FALLEN AS A RESULT OF THAT EXCEPTION. A BLOCK TRADING EXCEPTION WOULD NOT RELIEVE INSTITUTIONAL INVESTORS OR THEIR BROKERS OF THE DUTY OF BEST EXECUTION, BUT IT WOULD AVOID LIMITING THEIR CHOICES, WHICH A TRADE-THROUGH RULE WITHOUT SUCH AN EXCEPTION WOULD DO.

THIS IS NOT A QUESTION OF FAVORING ONE GROUP OF INVESTORS OVER ANOTHER — SUCH AS INSTITUTIONS OVER THE “SMALL

³ See, e.g., NYSE Rule 15A(e): “This rule shall not apply to . . . (2) any ‘block trade’ as defined in the Exchange’s ITS Block Trade Policy.” Consideration should be given to whether the Exchange’s ITS Block Trade Policy should be carried over into an SEC rule. It may well be that a simpler exemption, based solely on a trade’s being of block size, would suffice.

INVESTOR”. IF IT WERE, ONE MIGHT WELL QUESTION WHICH GROUP THE GOVERNMENT SHOULD FAVOR — THE WEALTHY STOCK PICKER OR CORPORATE EXECUTIVE OR DOCTOR WHO PUTS INDIVIDUAL TRADES INTO THE MARKET OR THE FIREMAN, POLICEMAN, SCHOOL TEACHER OR FACTORY WORKER WHOSE STATE OR UNION PENSION FUND, OR MUTUAL FUND, IS INVESTED BY CALPERS OR ANOTHER INSTITUTIONAL MANAGER.

BUT IN FACT THAT IS *NOT* THE QUESTION. THE GOVERNMENT NEED NOT MAKE THAT CHOICE. INSTEAD IT SHOULD CHOOSE TO LET INVESTORS MAKE THEIR OWN CHOICES AS TO HOW TO EXECUTE BLOCKS WITHOUT GOVERNMENTAL COMPULSION. IN THE CASE OF INSTITUTIONS, WE DOUBT THEIR DUTIES OF BEST EXECUTION WILL CAUSE THEM TO BYPASS READILY ACCESSIBLE AND IMMEDIATELY EXECUTABLE PRICES AS A ROUTINE MATTER. IN ANY EVENT, WE ARE NOT AWARE OF ANY EVIDENCE THAT THE EXISTING BLOCK EXCEPTION HAS BEEN DELETERIOUS.

IF THE COMMISSION WERE INSTEAD TO PROVIDE ONLY ITS FAST-TO-SLOW OPT OUT FROM A TRADE-THROUGH RULE NOT HAVING A BLOCK EXCEPTION, WE THINK THE RESULT WOULD BE TO FORCE INVESTORS TO CHOOSE BETWEEN SPEED AND PRICE. THAT WOULD RUN EXACTLY COUNTER TO THE COMMISSION'S NOTION OF WHAT BEST EXECUTION IS ALL ABOUT. THE ALTERNATIVE OPT-OUT PROVISION, FOR FAST MARKETS OPTING OUT OF SLOW MARKETS WITHIN A STATED PRICE

BAND, RAISES SUBSTANTIAL IMPLEMENTATION AND COMPLIANCE ISSUES. JUST AS THE SHORT SALE RULE PRESENTS PRACTICAL PROBLEMS IN A DECIMALIZED MARKET CHARACTERIZED BY FLICKERING QUOTES, WE BELIEVE THE FAST-TO-SLOW OPT OUT WOULD PRESENT AN EVEN GREATER PROBLEM OF IMPLEMENTATION. THE SLIDING SCALE OF PERMISSIBLE TRADE-THROUGH PRICING IS JUST TOO COMPLICATED, PARTICULARLY AS IT WOULD PRESENT MULTIPLE MOVING TARGETS AND INVITE ALL SORTS OF GAMESMANSHIP. A MARKET-DRIVEN DETERMINATION MIGHT WELL RELY ON COMPETITION AMONG MARKET CENTERS TO EMBRACE TECHNOLOGY IN PLACE OF A GOVERNMENT MANDATE.

X. THE MARKET DATA PROPOSALS

MARKET DATA IS THE “OXYGEN” OF THE MARKETS. ENSURING THAT MARKET DATA IS AVAILABLE IN A FASHION WHERE IT IS BOTH AFFORDABLE TO RETAIL INVESTORS AND WHERE MARKET PARTICIPANTS HAVE THE WIDEST POSSIBLE LATITUDE TO ADD VALUE TO THAT DATA ARE HIGH PRIORITIES.

BEFORE THE 1970S, NO STATUTE OR RULE REQUIRED SELF-REGULATORY ORGANIZATIONS (SROS) TO DISSEMINATE MARKET INFORMATION TO THE PUBLIC OR TO CONSOLIDATE INFORMATION WITH INFORMATION FROM OTHER MARKET CENTERS. INDEED, THE NYSE, WHICH OPERATED THE LARGEST STOCK MARKET, CLAIMED AN

OWNERSHIP INTEREST IN MARKET DATA, SEVERELY RESTRICTING ACCESS TO MARKET INFORMATION. MARKETS AND INVESTORS SUFFERED FROM THIS LACK OF TRANSPARENCY.

AT THE URGING OF THE SEC, CONGRESS RESPONDED BY ENACTING THE SECURITIES ACTS AMENDMENTS OF 1975. THESE AMENDMENTS EMPOWERED THE SEC TO FACILITATE THE CREATION OF A NATIONAL MARKET SYSTEM FOR SECURITIES, WITH MARKET PARTICIPANTS REQUIRED TO PROVIDE — IMMEDIATELY AND WITHOUT COMPENSATION — INFORMATION FOR EACH SECURITY THAT WOULD THEN BE CONSOLIDATED INTO A SINGLE STREAM OF INFORMATION.

AT THE TIME, THE CONGRESS CLEARLY RECOGNIZED THE DANGERS OF DATA-PROCESSING MONOPOLIES. THE REPORT ACCOMPANYING THE 1975 AMENDMENTS EXPRESSLY WARNS THAT:

PROVISION MUST BE MADE TO INSURE THAT THIS CENTRAL PROCESSOR IS NOT UNDER THE CONTROL OR DOMINION OF ANY PARTICULAR MARKET CENTER. ANY EXCLUSIVE PROCESSOR IS, IN EFFECT, A PUBLIC UTILITY, AND THUS IT MUST FUNCTION IN A MANNER WHICH IS ABSOLUTELY NEUTRAL WITH RESPECT TO ALL MARKET CENTERS, ALL MARKET MAKERS, AND ALL PRIVATE FIRMS.⁴

⁴ Report of the Senate Comm. on Banking, Housing, and Urban Affairs to Accompany S.249, S. Rep.No. 94-75, 94th Cong., 1st Sess. 11 (1975).

**XI. CURRENT FEES FOR MARKET DATA ARE EXCESSIVE —
THEY SHOULD BE COST-BASED**

EVEN AS NOT-FOR-PROFIT ENTITIES, SROS HISTORICALLY HAVE EXPLOITED THE OPPORTUNITY TO SUBSIDIZE OTHER COSTS (E.G., EXECUTIVE COMPENSATION, COST OF MARKET OPERATION, MARKET REGULATION, MARKET SURVEILLANCE, MEMBER REGULATION) THROUGH THEIR GOVERNMENT-SPONSORED MONOPOLY ON MARKET INFORMATION FEES. WHILE THIS SUBSIDY IS TROUBLING ENOUGH, THE INCENTIVE TO EXPLOIT THIS MONOPOLY POSITION WILL BE EVEN STRONGER AS SROS CONTEMPLATE FOR-PROFIT FUTURES AND NEW LINES OF BUSINESS.

IN ITS 1999 CONCEPT RELEASE ON MARKET DATA, THE COMMISSION NOTED THAT MARKET DATA SHOULD BE FOR THE BENEFIT OF THE INVESTING PUBLIC. INDEED, MARKET DATA ORIGINATES WITH SPECIALISTS, MARKET MAKERS, BROKER-DEALERS AND INVESTORS. THE EXCHANGES AND THE NASDAQ MARKETPLACE ARE NOT THE SOURCES OF MARKET DATA, BUT RATHER THE FACILITIES THROUGH WHICH MARKET DATA ARE COLLECTED AND DISSEMINATED. IN THAT 1999 RELEASE, THE SEC PROPOSED A COST-BASED LIMIT TO MARKET DATA REVENUES. WE BELIEVE THE SEC WAS CLOSER TO THE MARK IN 1999 WHEN IT PROPOSED MAKING MARKET DATA REVENUES COST-BASED, THAN IN ITS REGULATION NMS PROPOSAL, WHICH SETS FORTH A NEW FORMULA FOR DISPENSING MARKET DATA REVENUE WITHOUT ADDRESSING THE

UNDERLYING QUESTION OF HOW TO EFFECTIVELY REGULATE THIS MONOPOLY FUNCTION.

EVERY INVESTOR WHO BUYS AND SELLS STOCKS HAS A LEGITIMATE CLAIM TO THE OWNERSHIP OF THE DATA AND LIQUIDITY HE OR SHE PROVIDES TO MARKET CENTERS. FUNNELING EXCLUSIVE LIQUIDITY INFORMATION TO EXCHANGE MEMBERS AND FUNNELING MARKET DATA REVENUES TO EXCHANGES AND NASDAQ AND NOT TO INVESTORS SHIFTS THE REWARDS FROM THOSE WHO TRADE TO THOSE WHO FACILITATE TRADING. THE BENEFITS OUGHT TO BE CONFERRED UPON THE PUBLIC.

UNDER THE CURRENT SYSTEM, MARKET DATA REVENUES PROVIDE SROS WITH FUNDS TO COMPETE WITH OTHER EXECUTION CENTERS. FOR EXAMPLE, ARCHIPELAGO HOLDINGS RECENTLY FILED AN IPO REGISTRATION STATEMENT WITH THE COMMISSION IN WHICH IT REPORTED SOME \$23 MILLION FOR 2003 REVENUE FROM MARKET DATA. THIS WAS NET OF \$7.5 MILLION PAID TO THE PACIFIC STOCK EXCHANGE FOR MARKET REGULATION SERVICES. ARCHIPELAGO FURTHER STATED THAT IT USES THIS REVENUE TO COMPETE WITH NASDAQ, THE NYSE AND ECNS, SUCH AS BLOOMBERG TRADEBOOK. THAT IS, THE MARKET DATA REVENUES ARCHIPELAGO RECEIVES AS AN EXCHANGE ARE, IN EFFECT, GOVERNMENT-SANCTIONED SUBSIDIES THAT CONFER A SPECIAL — AND

WE BELIEVE UNFAIR — COMPETITIVE ADVANTAGE ON ARCHIPELAGO
AND SIMILARLY SITUATED SROS.

THE COMMISSION’S PROPOSAL WITH RESPECT TO MARKET DATA
WOULD PERPETUATE THE EXCLUSIVE AND LUCRATIVE FRANCHISE SROS
ENJOY OVER THE COLLECTION, DISSEMINATION AND SALE OF MARKET
DATA. AS SUCH, THE COMMISSION HAS A STATUTORY DUTY TO ENGAGE
IN RATEMAKING PROCEEDINGS WITH RESPECT TO THESE GOVERNMENT-
SANCTIONED MONOPOLIES. IT IS TRULY NECESSARY FOR THE
COMMISSION TO ASSESS THE FAIRNESS AND REASONABLENESS OF THE
NYSE AND NASDAQ MARKET DATA FEES — FEES FOR WHAT ARE
ESSENTIALLY MONOPOLY SERVICES. IF THOSE FEES ARE EXCESSIVE OR
POORLY STRUCTURED, THEY MAY HAVE CREATED MARKET DISTORTIONS
AND ALLOWED THOSE ENTITIES TO EXTRACT MONOPOLY RENTS FROM
THE INVESTING PUBLIC FOR OVER A GENERATION.

SIGNIFICANTLY, NASDAQ’S ROBERT GREIFELD CANDIDLY
ADMITTED AT THE COMMISSION’S REGULATION NMS HEARING ON APRIL
21 THAT THE EXISTING DATA FEES ARE TOO HIGH:

[W]E BELIEVE THE GOVERNMENT SHOULD ONLY BE INVOLVED
WHERE THE GOVERNMENT MUST BE INVOLVED. SO WE MUST LIMIT
THE MONOPOLY TO THE DATA THAT IS PART OF THE PUBLIC GOOD,
AND PROVIDE IT AT A LOW COST . . .

WITH THE CURRENT STRUCTURE . . . DATA IS NOT PROVIDED AT A LOW ENOUGH COST AND IT DOES CREATE . . . UNINTENDED RESULTS AND DISTORTIONS IN OUR MARKET. THE MARKET CENTERS TODAY ARE THE BENEFICIARIES OF THAT EXCESSIVE RENT⁵

XII. MANDATORY MARKET DATA SHOULD BE EXPANDED

IN ADDITION TO QUESTIONS REGARDING WHO OWNS MARKET DATA AND WHO SHARES IN THE REVENUE AND THE SIZE OF DATA FEES, WE BELIEVE THE COMMISSION OUGHT ALSO TO REVISIT HOW MUCH MARKET DATA SHOULD BE MADE AVAILABLE TO INVESTORS. HERE, DECIMALIZATION HAS BEEN THE WATERSHED EVENT. GOING TO DECIMAL TRADING HAS BEEN A BOON TO RETAIL INVESTORS. IT HAS BEEN ACCOMPANIED, HOWEVER, BY DRASTICALLY DIMINISHED DEPTH OF DISPLAYED AND ACCESSIBLE LIQUIDITY. WITH A HUNDRED PRICE POINTS TO THE DOLLAR, INSTEAD OF EIGHT OR SIXTEEN, THE INFORMATIONAL VALUE AND AVAILABLE LIQUIDITY AT THE BEST BID AND OFFER HAVE DECLINED SUBSTANTIALLY.

PARTICULARLY GIVEN THE EFFECTS OF DECIMALIZATION, ALLOWING THE NYSE, FOR EXAMPLE, TO HOLD MARKET DATA AND LIQUIDITY BACK FOR THE BENEFIT OF ITS FLOOR MEMBERS IS AGAINST THE PUBLIC INTEREST. THE COMMISSION HAS HEARD COMPLAINTS

⁵ Statement by Robert Greifeld, President and CEO of The Nasdaq Stock Market, Inc. at SEC Hearings on Regulation NMS (April 21, 2004), available at <http://www.sec.gov/spotlight/regnms/nmstrans042104.txt> (pp. 223-4).

BEFORE ABOUT THE NYSE AUCTION PROCEDURES THAT ALLOW HIDDEN AGENCY AND SPECIALIST ORDERS HELD IN THE CROWD TO HAVE PRICE-TIME PRIORITY OVER ORDERS DISPLAYED VIA THE PUBLIC QUOTATION SYSTEM. THESE FLOOR PROCEDURES GIVE NYSE MEMBERS AN UNFAIR OPPORTUNITY TO JUMP AHEAD OF, OR TO “PENNY”, PUBLICLY DISPLAYED LIMIT ORDERS AND TO “GO ALONG”, OR HITCH A RIDE, ON LARGE INSTITUTIONAL MARKETABLE ORDERS.

IN RESPONSE TO DECIMALIZATION, THE COMMISSION SHOULD RESTORE LOST TRANSPARENCY AND LIQUIDITY BY MANDATING GREATER REAL-TIME DISCLOSURE BY MARKET CENTERS OF LIQUIDITY AT LEAST FIVE CENTS ABOVE AND BELOW THE BEST PRICES. GIVEN THE INCENTIVES OF A SLOW MARKET SUCH AS THE NYSE TO HIDE QUOTATION INFORMATION AND TO BLOCK DIRECT ACCESS TO LIQUIDITY, THE REAL-TIME DISCLOSURE OF LIQUIDITY SHOULD NOT BE LEFT TO “MARKET FORCES”, WHICH CAN WORK IN THIS INSTANCE ONLY IF DISCLOSURE IS MANDATED. THIS WOULD RESTORE THE TRANSPARENCY AND DIRECT ACCESS INVESTORS HAD BEFORE THE ADVENT OF DECIMALIZATION.

WE REMAIN CONCERNED THAT THE PROMISE OF DECIMALIZATION WILL BE FRUSTRATED IF THE NYSE IS GRANTED GREATER RIGHTS TO DATA THAT REPRESENTS TRADING INTEREST IN A DECIMALIZED ENVIRONMENT — IN THE CONTEXT OF MARKET DATA FEES, ACCESS FEES,

OR CONTROL OF USES OF INFORMATION — THAN THE NYSE ENJOYED WHEN TRADING INTEREST WAS EXPRESSED IN EIGHTHS AND SIXTEENTHS.

XIII. ACCESS FEES SHOULD BE ABOLISHED

THERE ARE TWO BASIC ISSUES IN THE DEBATE OVER ACCESS FEES, HOW THEY AFFECT QUOTATIONS AND HOW THEY ARE PAID. THE ACCESS FEE DEBATE COULD BE RESOLVED WITH TWO SIMPLE MEASURES:

(1) ADJUST QUOTATIONS TO REFLECT ACCESS FEES, AND (2) DO NOT AUTOMATICALLY ROUTE ORDERS TO VENUES THAT FORCE PAYMENT OF HIDDEN ACCESS FEES. IF THESE CONDITIONS WERE MET, THERE WOULD BE NO REASON TO REGULATE ACCESS FEES. FREE MARKETS WOULD FIND APPROPRIATE FEE LEVELS. CURRENT SEC REGULATION DOES NOT ADEQUATELY ADDRESS THE ISSUE AND ALTHOUGH THE COMMISSION TAKES POSITIVE STEPS IN THE REG NMS PROPOSAL, IT MISSES AN OPPORTUNITY TO FULLY ADDRESS THE ISSUE.

BECAUSE OF THEIR DISTORTING AFFECTS UPON THE MARKETS, BLOOMBERG TRADEBOOK HAS LONG BELIEVED THAT ACCESS FEES SHOULD BE ABOLISHED FOR ALL SECURITIES AND ALL MARKETS. WHILE WE APPLAUD THE SEC'S EFFORTS TO REDUCE ACCESS FEES, WE ARE CONCERNED THAT THE COMPLEXITIES INHERENT IN CURTAILING THESE FEES WITHOUT ELIMINATING THEM ARE LIKELY TO CREATE AN UNEVEN PLAYING FIELD.

WE ARE ALSO CONCERNED THAT THE PROPOSED LIMITATIONS ON ACCESS FEES IN REGULATION NMS APPLY ONLY TO THE TOP OF THE FILE, I.E., TO THE BEST BID AND OFFER. WHILE ECNS' FEES WILL BE LIMITED BY THE AMOUNT PERMITTED UNDER THEIR CURRENT NO-ACTION LETTERS, BY CONTRAST, THE COMMISSION'S ACCESS FEE PROPOSAL DOES NOT APPLY TO ACCESS FEES FOR QUOTES BEYOND THE NBBO.

NORMALLY, WE WOULD BE TOTALLY IN FAVOR OF LETTING A BUSINESS DETERMINE ITS OWN PRICING WITHOUT GOVERNMENTAL INTERFERENCE — WITH SOME OBVIOUS EXCEPTIONS SUCH AS PUBLIC UTILITIES AND OTHERS WHO ENJOY MONOPOLIES OF ONE SORT OR ANOTHER. IN THE CASE OF ECN ACCESS FEES, HOWEVER, THERE ARE TWO IMPORTANT FACTORS — FIRST, AN IMPORTANT QUESTION IS AT WHAT POINT SHOULD AN ECN HAVE TO ADJUST ITS PUBLISHED QUOTATIONS TO REFLECT THE ACCESS FEES IT WILL TACK ON TO INVESTORS' TRADES. THAT IS IMPORTANT TO AVOID BAIT-AND-SWITCH PROBLEMS ARISING FROM HIDDEN CHARGES. THE SECOND IS A RELATED QUESTION. WITH SUPERMONTAGE, BROKERAGE FIRMS ENTERING ORDERS HAVE THEM EXECUTED AGAINST THE BEST REPORTED QUOTATION — WHICH MAY BE AN ECN THAT CHARGES ACCESS FEES. IN EFFECT, THEY ARE FORCED TO PAY THE FEES EVEN IF THEY WOULD HAVE CHOSEN NOT TO. IT'S LIKE BEING FORCED TO EAT AT A LUNCHEONETTE WHERE YOU DON'T LIKE THE PRICES. THOSE TWO FACTORS JUSTIFY CAPPING AND INDEED PROHIBITING ACCESS FEES OUTRIGHT.

WE SUGGEST THAT, IN ANY EVENT, IT MAKES LITTLE SENSE TO EXPAND THE UNIVERSE OF MARKET PARTICIPANTS WHO CAN CHARGE ACCESS FEES. WITH THE EXCEPTION OF ONE ECN — INET — WE ARE NOT AWARE OF ANY SIGNIFICANT SUPPORT FOR THE CONTINUATION OF ACCESS FEES. BROKER-DEALERS, EXCHANGES, ECNS, SROS SHOULD ALL COMPETE ON THE BASIS OF THE MERIT OF THEIR SERVICE, NOT ON THE BASIS OF ACCESS FEES. ACCESS FEES ENCOURAGE INTERNALIZATION OF ORDERS, UNDISPLAYED ORDERS AND PAYMENT FOR ORDER FLOW. THE COMMISSION SHOULD LOOK TO STAMP THEM OUT.

XIV. SUBPENNY QUOTING

THE COMMISSION CLEARLY OPTED FOR THE RIGHT CHOICE IN PROPOSING TO BAN SUBPENNY QUOTING. THE VIRTUALLY UNIVERSAL CONSENSUS AMONG COMMENTERS APPLAUDED THAT MOVE. SUBPENNY QUOTING WOULD FURTHER REDUCE TRANSPARENCY AND ENCOURAGE JUMPING AHEAD OF ORDERS.

CONCLUSION

THIS COMMITTEE HAS BEEN IN THE FOREFRONT OF THE MARKET STRUCTURE DEBATE AND I APPRECIATE THE OPPORTUNITY TO DISCUSS HOW THESE SEEMINGLY ABSTRACT ISSUES HAVE A CONCRETE REAL-WORLD IMPACT ON INVESTORS.

REGULATION NMS IS A BOLD STEP TO BRING OUR MARKETS INTO THE 21ST CENTURY. THE SEC IS TO BE COMMENDED FOR PROMPTING WHAT HAS ALREADY BEEN A PRODUCTIVE DEBATE. IN AN EFFORT TO ACCOMMODATE A DIVERSE ARRAY OF INTERESTS, HOWEVER, WE BELIEVE THERE IS A RISK THAT REGULATION NMS MAY RE-SHUFFLE, RATHER THAN ELIMINATE, CURRENT IMPEDIMENTS TO MARKET EFFICIENCY.

ELIMINATION OF THE TRADE-THROUGH RULE, ELIMINATION OF ACCESS FEES, AND GREATER EFFORTS TO ENHANCE THE TRANSPARENCY AND CONTROL THE COSTS OF MARKET DATA WOULD HELP PROMOTE A 21ST CENTURY EQUITY MARKET THAT BEST SERVES INVESTORS.
