PERFORMANCE THROUGH INNOVATION
BARCLAYS GLOBAL INVESTORS

January 26, 2005

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

Re: Proposed Rule: Regulation NMS (File No. S7-10-04)

Dear Mr. Katz:

We are writing on behalf of Barclays Global Investors, N.A. ("BGI") concerning the Securities and Exchange Commission's proposals for a new Regulation NMS ("Reg. NMS").[1] We greatly appreciate the opportunity to provide comment on these important issues, and look forward to working with the Commission to improve the quality of our financial markets.

BGI is one of the world's largest institutional investment managers, and the world's largest provider of structured investment strategies such as indexing, tactical asset allocation, and quantitative active strategies. BGI manages over a trillion dollars in assets in both active and index strategies. BGI is a subsidiary of Barclays Bank PLC.

The proposal's objective is to modernize and restructure the Exchange Act rules governing the NMS to enhance and modernize the national market system. BGI is committed to delivering best execution in the trading activity we undertake on behalf of our clients. We support initiatives designed to promote competitive and open market structures that reflect best practices and maximize the opportunity for best execution of market participant's orders.

Collectively, these are the most significant market structure regulatory initiatives since the Order Handling Rules (1997), Regulation ATS (1999), and decimalization (2001), with far reaching consequences for investors and market participants. On December 16, 2004, the SEC amended the proposal in significant ways, most importantly regarding the uniform trade-through rule.

Uniform Trade-Through Rule

The proposed uniform trade-through rule for all NMS market centers prohibits the execution of an order in one execution venue at a price inferior to a price displayed in

[1] Securities Exchange Act Release No. 49325 (Feb. 26,2004), 69 Fed. Reg. 11126 (Mar. 9,2004) ("NMS Proposal") ; Securities Exchange Act Release No.49749 (May 20, 2004), 69 Fed. Reg. 30142 (May 26, 2004) (the "Supplemental Release"); and Securities Exchange Act Release No. 50870 (December 16, 2004), 69 Fed. Reg. 77424 (December 27, 2004).

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another venue. Two alternatives are presently under discussion. The first alternative provides trade-through protection for the Best Bid or Offer in each market. It is important to note that the proposal concerns only the Automated Quotes from Automated Trading Centers. The second alternative goes farther than the first ("top-of-book" protection) in extending trade-through protection to the entire depth-of-book, again only for Automated Quotes an Automated Trading Center volunteers for protection. Unlike the original proposal, there is no investor "opt out" provision, although there are exemptions. The original trade-through rule (1981 ITS trade-through rule) requires that trades in listed stocks execute at the best intermarket quote. Both alternative proposals to revise Reg. NMS expand trade-through coverage to include NASDAQ stocks.

Proponents of the trade-through rule (including the NYSE) believe the rule protects investors from receiving anything but the best price and encourages price competition and market transparency, while reducing the potentially deleterious effects of market fragmentation. Further, these proponents believe that weakening or eliminating the rule could result in increased transaction costs, harming investors and reducing liquidity. Critics of the rule believe that there are other factors in "best execution" other than price, such as the ability to execute in large size, quickly (through automated or electronic systems) and anonymously. They note that the NASDAQ market, which functions without trade-through protection, is highly competitive. Further, for institutional investors with the ability to closely monitor trade execution and trading costs, trade-through protection need not be required. Further, technological innovations, including new routing systems that offer inter-market "sweep" functionality, are effectively unifying the markets without the need for regulatory intervention. In the view of critics, the extended trade-through rule ("depth-of-book") represents a dramatic shift in market structure with potentially unknown consequences.

BGI supports regulatory reform that encourages competition and efficiency, greater transparency, and the provision of liquidity in our capital markets. In particular, while we affirm the importance of price priority as a guiding principle, we believe that it is important to distinguish between intra-market competition and inter-market competition. Competition within a particular market on pricing, given existing technological structure and trading protocols, reduces transaction costs, while inter-market competition might take other forms, encouraging innovation in market structure. In our view, a unified market structure, which encourages competition within and between market centers, will best satisfy these regulatory objectives.

In terms of the specific proposals, we favor the first proposal for top-of-book protection. In our view, this proposal strikes the right balance given the importance of continued innovation among market centers and the need to preserve price priority. We also strongly favor the "opt out" provisions contained in the Commission's original proposal. Indeed, based on years of empirical evidence and substantial quantitative research into the components of transaction costs, it is our strong belief that price is just one element in overall execution quality. Institutional traders often need to trade off price for liquidity, speed of execution, likelihood of completion, and other attributes. We believe investors should have the choice over where to execute their orders, considering these other attributes, and that regulatory reform should continue to encourage market centers to compete in all these dimensions of execution quality.

By contrast, BGI believes there are legitimate concerns that the second, depth-of-book, trade-through rule proposal will fundamentally alter the nature of inter-market competition, effectively creating a Consolidated Limit Order Book (CLOB) as envisioned in the early days of the National Market System. It is not clear to us whether this type of market structure would promote inter-market competition, or even if it is warranted given technological advances. There are also concerns regarding how this extended proposal would work. For example, would it apply to all displayed orders? If so, what is the Commission's approach towards ensuring consistency of rules concerning non-displayed orders within a given venue? Further study and clarification of the new alternative (extending trade-through to the entire depth-of-book) is warranted, as is a reconsideration of the opt-out provision.

Other Reg. NMS Proposals

We also thought it would be helpful to the commission for us to share our thoughts on some of the other key provisions of the original. NMS Proposal, especially as they pertain to our overall view of market structure reform.

Access Rules

The NMS Proposal suggests a uniform market access rule with a de minimis fee standard to assure non-discriminatory access to the best prices displayed by NMS market centers, without mandating inflexible linkages such as the Intermarket Trading System ("ITS"). The market access rule mandates uniform access to quotes. It will cap quote access fees, but does not impose linkages. In our opinion, the uniform access to quotes will enhance competition among market centers, improve transparency, and improve price efficiency. However, we remain concerned at any effort to mandate or determine market prices, such as access fees, through regulatory means. Rather, we favor regulation to ensure market forces function competitively.

Market Data Fees

The NMS Proposal provides for amendments to the current rules governing the dissemination of market information to reward Self-Regulatory Organizations ("SROs") for their contributions to public price discovery, and implement many of the recommendations of the Commission's Advisory Committee on Market Information. The proposal on market data proposes new formula to allocate market data revenues across execution venues, based on trading and quoting activity. We favor reform of the current formula for allocating market data revenues, which we believe leads to distortions and inefficiencies. These include payment for order flow and reporting practices that obfuscate real trading patterns. However, although the proposal is a step in the right direction, the rule change does not address the overall level of these fees, or the manner in which they are determined.[2] In our view, the rule change will not induce greater competition in information provision, and as a result, it is unclear what the impact this will have on practices such as payment for order flow that is reliant on tape revenues. Further analysis is needed, in our opinion, of the proposed rule change prior to enactment. We do not believe that the market data proposal is integral to the NMS Proposal as a whole, and thus action on it could be postponed even if the Commission decides to proceed on other parts of the NMS reform.

Sub-Penny Quoting Rule

The Proposal on sub-penny quoting prohibits market participants from ranking or displaying prices in any NMS stock in stocks priced over $1.00. Many ECNs display quotes in sub-pennies, but these quotes are not transparent because they are not disseminated to the public. Further, some market participants use sub-penny quoting to step in front of competing limit orders. This practice, which weakens time priority, discourages limit order submission, in turn possibly reducing market liquidity. Sub-penny quoting can also cause flickering quotes and complicate the process of satisfying best execution. In BGI's opinion, a discrete minimum price increment is needed for financial markets to maintain time priority and encourage the provision of liquidity by limit orders. Regulation is needed to set this increment in a uniform manner across all market centers. The rule change accomplishes these objectives, and we endorse the Commission's recommendation.

Conclusion

In summary, we believe that this is the right time to substantially reform the NMS. The Commission's proposals have already generated healthy debate that will improve trading practices, benefiting all investors. We agree with the overall sentiment behind the commission's objective of increasing transparency and competition, but believe that certain specific proposals – particularly extending the trade-through rule across entire depth-of-book – might conflict with the goal of encouraging innovation among market centers. We are also concerned that the proposed rule changes do not adequately recognize that best execution has many dimensions besides price. As an over-riding principle, we believe that regulation should promote free competition and provide a level playing field.

[2] In 2003, the exchanges and Nasdaq earned $424 million in market data revenue, with total expenses of $38 million. By contrast, ECNs offer relatively complete Level II (depth-of-book) data at much lower prices, as do many exchanges outside the United States.

We thank you again for the opportunity to contribute to this important debate on the structure of the securities industry. We are happy to discuss these issues in more detail in person or by telephone. If you have any questions or comments, please feel free to contact me directly.

Yours Sincerely,

Minder Cheng
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