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Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, D.C. 20549

Re: S-07-10-04/Regulation NMS

To the Commission:

The following comments are submitted on behalf of Domestic Securities, Inc., the owner/operator of the ATTAIN® ECN. We congratulate the Staff of the Commission, who have done an excellent job in formulating this proposal. The comments herein are in no way meant to disparage the Staff's work, but merely to add the voice of a growing ECN on issues of concern to it regarding access fees.

Although not required to do so, market makers generally have elected not to pass along their ECN costs directly to their customers. The market makers complain about the fees of the ECNs because they have chosen to absorb these costs, which then eat into their profitability. More galling still to market makers, these access fees not only reduce their profitability, but go into the pockets of their competitors, the ECNs, which have also reduced market maker profitability by narrowing the spread.

How Access Fees Cause Distortion in the Markets: Is Non-transparency of ECN Access Fees a Problem or a Red Herring?

The very title of this section assumes that ECN access fees do, in fact, cause distortion and assumes that market professionals do not know what the ECN access fees are. One claim that most assuredly is a red herring is the lack of transparency of ECN fees. There are only six ECNs, and they have relatively simple cost structures. It simply defies credibility that these costs are other than well known to professional traders, just as Nasdaq and exchange fees are also well known to all market professionals. Because ECN access fees are not passed through, customer perception is not relevant. In fact, many wire houses employ smart order routers, into the algorithms of which is built the knowledge of precisely what fees apply at any given point.

Non-subscribers Should Not Be Forced To Pay a Fee for Execution of Agency Orders:

The costs of obtaining, displaying and executing ECN liquidity can be borne by adders or takers of liquidity. To attract new liquidity, ECNs have paid those who add liquidity, rather than those who remove it. The cost of that inducement, as well as ECN administrative costs and a small profit, are passed along to those who wish to benefit from the better price so displayed. The customer adding the liquidity is taking real economic risk. It is counter-intuitive to expect that person to pay for the privilege. When market makers take risk, they stand to earn at least the spread for their effort. The so-called "rebate" is the customer's reward for taking a similar risk. Although it is true that a market maker is required to post a quote all day, the market maker can easily "stay out of the way" and limit its risk. It can further limit its risk by posting only the minimum hundred share quote. Logically, those who wish to hit a posted quote should pay the ECN access fee. If the ECN quote were not on the inside, the customer would be paying the market maker a higher price and giving the market maker the spread. The cost of getting the lower ECN quote is to pay the ECN for its cost of doing business plus a small profit.

The markets have come a long way, so far perhaps, that we have lost some perspective. A decade ago, before the odd-eighth controversy, stocks generally traded in 25 cent intervals. We are now arguing about ECNs charging a fee that is less than a penny per share. We must keep in mind that it is the ECNs, not the market makers, that brought about penny spreads. But for the ECNs, market makers would immediately widen the spreads out and they have publicly said as much.

Payment of Rebates Has Led to Proliferation of Locked and Crossed Markets:

Locked markets are arguably a perfect economic world. They represent complete agreement about what a particular security should cost. Although prohibitions against locked and crossed markets provide some resolution of this problem, if it is a problem, what remains is dueling marketplaces and the fight to earn, rather than pay, fees. The solution, in a perfect world, is that the one who posts his idea first does and should earn the fee, because he took the first risk. If someone can trade through his quote, the initial market participant post has given away his idea for nothing. However, this requires a unified black box with strict price/time priority. Thus far, both market participants and regulators have been reluctant to wipe out the competing markets that have become fertile ground for innovation, ever faster executions, ever smaller spreads and ever increasing liquidity based on earning rebates.

To our knowledge, no study has been undertaken by the Commission to evaluate the benefit rebate earners, primarily black box traders, bring to the market in increased liquidity and price improvement. To wipe out this liquidity and price improvement by eliminating rebates through a *de minimus* access fee requirement before thoroughly understanding the degree of market liquidity benefit and price improvement that would thus be eliminated seems, at best, unwise. Before acting to "fix things", the Commission should assure itself that it is doing the market no harm. A very squeaky wheel should not be greased if the grease causes harm to the wagon as a whole.

The *de minimus* access fee requirement amounts to rate fixing. ECN fees are comparable to commissions; commission rates were unfixed long ago. Does the SEC now propose to resurrect rate fixing?

The Commission has suggested that varying ECN rates may be discriminatory. Varying ECN rates arrived at through volume discounts or individual negotiation simply do not amount to *per se* discrimination against any market participant or group of market participants but rather reflect traditional competitive forces of negotiating power through volume or plain old persuasiveness.

The Commission has stated that some ECNs are programmed to lock markets automatically. Since ECNs represent agency orders, it is unclear how or why this would be possible as a trading strategy if the Commission simply proscribed locking or crossing markets. In the Commission's view, impediments to access may lead to locked markets, create difficulty for market participants seeking best execution for customer orders, and call into question the efficiency of the marketplace. Access fees are not the equivalent of impediments to access, which is a perjorative term that should not be applied to a fee of less than a penny per share. Most benefits have a price. Price improvement is not without some cost - the cost to have that price improvement in the first place. And for ECNs, price improvement comes at the cost of rebates.

The Commission should consider viewing rebates as a liquidity generator, a net benefit to the public investor which create a new opportunity for improved execution price, even with the cost of the access fee, rather than as an impediment to access.

The Commission's solution to deliberate locking of markets across market centers is the equivalent of killing a mosquito with a bazooka. The more appropriate solution would be to bar locked markets across any other fast market.

Subpennying:

Subpennying and flickering quotes are problems that must be dealt with. However, the technology to display access fees in subpennies without at the same time allowing orders to be displayed in subpennies for any other reason is technologically feasible. If the Commission is concerned about transparency of access fees, have them shown in subpennies and limit subpennies to that purpose. The smart order routing systems already do this, presumably without undue difficulty.

Subpennying within an alternative trading system should not be prohibited. The subscribers are willing participants and should be permitted to trade this way if they choose to.

Very truly yours,

Linda Lerner

General Counsel