THE FINANCIAL SERVICES ROUNDTABLE

I Impacting Policy. Impacting People.

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February 4, 2005

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

Re: Regulation NMS, File No. S7-10-04

Dear Mr. Katz:

The Financial Services Roundtable[1] appreciates the opportunity to provide comments on the above-captioned proposal offered by the Securities and Exchange Commission (the "Commission" or the "SEC").

Background

On February 26, 2004, the SEC proposed Regulation NMS which addresses market structure reform in four main areas: trade-throughs, intermarket access, sub-penny quotes and market data. Subsequently, on December 15, 2004, the Commission re-published the rule for further comment. The new proposal contained several changes. The most significant elements in the new proposal are changes to the proposed trade-through rule. The reproposed trade-through rule would apply only to electronic markets. The Commission is proposing two alternatives for the scope of quotations to be protected. The first alternative would protect the best bids or offers of the nine self-regulatory organizations and Nasdaq whose members currently trade NMS stocks. The second alternative would protect the best bids or offers of the various self-regulatory organizations and Nasdaq, but would establish a mechanism for a market to voluntarily secure protection for its depth-of-book quotations at prices below its best bid or above its best offer. The reproposed rule no longer contains an exception allowing the investor to opt out of the trade-through rule and disregard displayed quotations.

[1] The Financial Services Roundtable unifies the leadership of large integrated financial services companies. Its membership includes nearly 100 firms from the banking, securities, investment and insurance sectors. In addition to communicating the benefits of integrated financial services to the American public, the Roundtable is a forum in which financial services industry leaders address critical public policy issues.

Roundtable Comments

The Roundtable applauds the Commission for addressing the need to modernize the structure of today's markets. We also commend the SEC staff for their efforts to address these difficult issues.

Roundtable member companies support a regulatory structure that promotes innovation, competition and efficiency. Historically, the marketplace has been able to determine the best market model. We agree with the Commission that recent changes in the marketplace, including the increased use of electronic trading, technological advances, and the entry of new trading venues warrants a review and possible market structure changes that promote competition and innovation. We are troubled, however, that the Commission intends to regulate the prices that investors pay for securities.

The Roundtable's primary concern with the reproposal involves the trade-through rule. The re-published rule represents a significant departure from what was originally proposed in Regulation NMS in February 2004. The Commission has stated that the re-published rule is necessary to encourage limit orders and increase liquidity in the marketplace. The Roundtable believes there is no evidence to demonstrate that the re-published rule would achieve these goals. Furthermore, there is no evidence to show that there is a current problem that needs to be addressed by regulation. We believe the reproposed trade-through rule may hinder competition and increase trading costs for investors.

Roundtable member companies believe the changes outlined in the re-published Regulation NMS could have an adverse impact on the efficiency of the markets and the economy in general. We urge the Commission to exercise caution before moving forward with this significant market structure reform. We appreciate the Commission's decision to re-publish Regulation NMS for further comment. The Roundtable would like to offer the following recommendations on the re-published Regulation NMS and re-iterate some of the views expressed in our original comment letter.[2]

Trade-Through Proposal

Under the Intermarket Trading System ("ITS"), which applies to the New York Stock Exchange and the American Stock Exchange, a member of a participating self-regulatory organization may not trade-through another market's quote. The Commission's originally proposed Rule 611 would have created a uniform trade-through rule for both exchange listed securities and Nasdaq securities. This trade-through rule would have guaranteed that a customer's order was executed at the best displayed price subject only to an exception that would allow investors to opt out of this protection. The Commission's original proposal also

[2] The Roundtable's comment letter on Regulation NMS dated June 30, 2004 may be found at www.fsround.org.

allowed an automated order execution facility to trade through a non-automated order execution facility.

The SEC's republished Rule 611 does not contain a general opt-out exception that would allow market participants to disregard displayed quotations (an exception that Roundtable members supported). The Commission's re-published rule requests comment on whether the price protection guaranteed under the trade through rule should: (1) be extended to each market's depth-of-book, or (2) whether it should apply only to the markets' automated best bids or offers (the "top-of-book" alternative). The SEC believes this approach would encourage limit orders and provide investors with price protection.

Roundtable member companies support the Commission's proposal to apply the trade-through rule only to automated quotes that have no human intervention. However, the Roundtable does not support either of the two proposed approaches toward applying the trade-through rule to the electronic markets. We believe that investors pursue vastly different trading strategies and therefore should be allowed to choose between immediacy of execution and best price. Investors are not only concerned with the price of the securities, but also the volume that they can acquire. Investors should be allowed to determine what volume they want to buy at a certain price rather than being forced to buy a small amount of shares at the best price. With the depth-of-book option, investors may be forced to buy several smaller blocks of shares at the best price before reaching the volume they want. The top-of-book option is equally as problematic. It forces the investor to execute trades they may be willing to forgo in lieu of receiving a certain amount of shares.

Roundtable member companies believe the reproposal would adversely affect order flow in the marketplace. As Commissioner Paul Atkins stated at the December 15, 2004 SEC open meeting, "the reproposed rule ties the markets together by forcing their depth-of-book information through a government sponsored consolidator that will distribute the protected quotations".[3] We are concerned that the price priority mandated by the reproposed trade-through rule would reduce the efficiency of the markets, increase trading costs and decrease innovation and competition.

There is no evidence that suggests the proposed trade-through rule is necessary. Many markets, including Nasdaq, operate without a trade-through rule and have had not experienced a large influx of trade-throughs as a result. The SEC's Office of Economic Analysis study referenced in proposed Regulation NMS showed that only 1.9% of Nasdaq's volume was traded through (over the four day period that was reviewed). We do not see any benefit that would outweigh the increased transaction costs to the investor and the potential disruption to the efficiency of the marketplace.

[3] See "Speech by SEC Commissioner: Remarks before the Open Meeting to Consider the Reproposal of Regulation NMS" by Paul Atkins (December 15, 2004).

The Roundtable recommends that the Commission consider other alternatives, such as the Securities Industry Association's ("SIA") proposal for a trade-through rule that protects only the automated national best bid or offer ("NBBO").[4] As SIA suggests, the NBBO alternative would: (1) strengthen existing price protection, (2) assist investors in obtaining the best price, (3) facilitate intermarket competition, (4) create incentives for appropriate quoting practices, and (5) minimize implementation challenges. In addition, although the Roundtable generally supports the exceptions outlined in the re-proposal, we would encourage the Commission to review the SIA's suggestion of creating an exception from the reproposed trade-through rule for certain actively traded, highly liquid securities.

Market Access Proposal

Proposed Rule 610 deals with the access to quotations and the execution of orders for equity NMS securities. This rule focuses on several factors that promote efficient intermarket access, including linkages and access fees.

Linkages

The Roundtable believes that intermarket linkage is important, especially if there is an intermarket price protection rule. Competing market centers must be connected in an efficient manner so that investors' orders can be routed to the market with the best price.

The Roundtable believes that financial institutions should maintain flexibility to determine how linkages work and how the technology is used. "Soft linkages," such as the model implemented by the NASD Display Facility, should be considered as an alternative to the current model of mandated "hard linkages." This would allow the marketplace a greater role to determine technology.

Access Fees

Under reproposed Rule 610, the Commission would limit the fees that any trading center can charge (or allowed to be charged) for accessing its protected quotations to no more than $0.003 per share. Some Roundtable members support the Commission's proposal to allow all broker-dealers, not just ECNs, to charge a *de minimis* access charge. They believe that this would help ensure that investors have reasonable access to quotes and ensures that they have access on standardized terms at all market centers. They also believe that it would provide certainty for all market participants. Other Roundtable member companies believe that access fees should be banned. They believe that such fees are an unnecessary tax on liquidity.

If, however, the Commission moves ahead with its access fee proposal, we request that the Commission further clarify the "access fee" definition. We believe that this definition

[4] See SIA's letter on the re-published Regulation NMS dated February 1, 2005.

should exclude brokerage commissions and should also account for the differences that exist among participants in the marketplace (*i.e.*, members, non-members, subscribers, non-subscribers, *etc.*).

Sub-Penny Pricing Proposal

Regulation NMS would prohibit exchanges from ranking, displaying, or accepting a bid or offer, or indication of interest in any NMS stock with a share price $1.00 or above in an increment less than $0.01.

The Roundtable supports these restrictions on quoting in sub-pennies. We agree with the significant concerns identified by the Commission in relation to sub-penny quoting. Sub-penny quotes may allow market participants to gain an execution priority over others' limit orders without a commensurately significant economic difference. Quoting in sub-pennies is also typically accompanied by rapidly changing quotes and difficulty in achieving best execution. The combination of these factors could discourage investors from placing limit orders, which would reduce liquidity.

In addition, sub-penny quotes on those markets displaying them are not readily visible to and accessible to investors. Many retail investors are not able to view or capture the rapid quote updates associated with sub-penny pricing. The growth of sub-penny pricing would therefore reduce transparency for some investors while creating a parallel market for those investors equipped with computerized systems that can capture and evaluate such information.

The Roundtable believes that quoting in sub-pennies would do little to promote more efficient markets, require additional investments in systems capacity by those who can afford them and potentially disadvantage those investors who cannot.

Market Data Proposal

Proposed Regulation NMS includes amendments to the current model for collecting and disseminating consolidated market information to market participants. The Roundtable believes that it is important for all market participants to have adequate access to market data in a timely, efficient and cost-effective manner. However, Roundtable member companies are concerned that the Commission's reproposal would further centralize the processing of market data. We believe this could result in unfair advantages for certain investors. We recommend that the Commission create market data rules that are fair and reasonable for all investors.

In its original letter, the Roundtable supported allowing broker-dealers greater freedom to make information available outside of their self-regulatory organizations. Requiring broker-dealers to make information available on terms that are fair and reasonable and not unreasonably discriminatory would allow firms to operate with different business models, while still ensuring that valuable information is available to investors.

The Roundtable also supports the proposal to increase the participation of market participants in the market data plans. Securing the input of broker-dealers, vendors and investors through advisory committees to the national market system plans would help increase the likelihood that the plans operate to serve the needs of investors in a cost-effective way. The Roundtable requests that the Commission consider extending representation of these parties to the plan operating committees to further promote a more cost-effective system of market data consolidation that serves investors' interests.

Finally, the Roundtable recommends that the Commission consider requiring the market data plans to adopt standardized accounting systems for the cost of producing consolidated market data, subject to independent audit and publication. This transparency would help ensure that only appropriate costs are passed along to investors in the form of market data fees, providing investors and the Commission with greater confidence that investors are not subsidizing markets improperly.

Conclusion

The Roundtable appreciates the Commission's efforts on Regulation NMS; however, we are discouraged by the new direction taken in the reproposal. The Roundtable believes that market structure reform should promote competition and efficiency of the markets, not place restrictions on what price investors pay for securities. We recommend that the SEC reconsider the proposal, especially the trade-through rule, in light of the suggestions we have offered.

We welcome the opportunity to discuss our concerns with the Commissioners and staff. If you have any questions or comments on this matter, please do not hesitate to contact me or John Beccia at (202) 289-4322.

Sincerely,

Richard M. Whiting

Richard M. Whiting
Executive Director and General Counsel