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

File S7-10-04

Dear Mr. Katz:

I submit these comments on the Commission's proposed Regulation NMS addressing that portion of the proposals offering protection for limit orders in all markets. These comments concentrate on some basic principles which have guided the Commission in the past. The Commission may want to consider these principles before making this major change in the equity markets. In this connection, it is fortunate for the investing public that the Commission has reproposed these rules and encouraged further public debate on issues of enormous importance to public investors.

Since the Securities Acts Amendment of 1975 which directed the Commission to establish an NMS, the Commission has wrestled with a broad and not well defined Congressional mandate. Rather than taking precipitate action, the Commission has wisely taken a step by step approach by approving several agreements among market participants: first, through a Consolidated Transaction Tape which consolidates and reports trade data from all participating markets; second, through dissemination of quotations in all securities from participating markets; and then through an Intermarket Trading System which permits participants to route orders among participating markets to execute trades with the best priced quotes. The current trade through rule is not a Commission rule but a provision agreed to by market participants in the ITS Plan. For the first time, the Commission itself - rather than market participants - is proposing a trade through rule.

The Commission, as it implemented the NMS, usually asked the question posed by Chairman Harold Williams in the 1970's: "How does one implement an Act of Congress and not jeopardize the only effective and trusted securities markets in the world?" The Commission did so by carefully avoiding any structural changes in the equity markets leaving such changes to the forces of competition, technology, investor preferences and other market factors.

What is unusual about these proposals is that they constitute, to quote the Commission's release, "a major overhaul of the existing structure of the NMS". They do so without any evidence of dissatisfaction by the ordinary investor with the structure of the equity markets. Rather, they seek to deal with the unhappiness of large institutional investors with the speed of execution of their orders and the leakage of information into the markets of what they are doing. Market centers competing with the NYSE are another source of dissatisfaction as they seek a greater share of order flow in NYSE listed stocks. Regulation NMS deals with disputes among market professionals, institutional investors and others who can fend for themselves - not with concerns of the ordinary public investor.

Since the 1980's, increased competition among market centers and technological advances together with decimalization have shaped the equity markets - all without Commission intervention. These changes have dramatically lowered transaction costs and the speed and quality of executions for investors. Continuing advances in order routing technology have made it possible for broker-dealers to route orders instantaneously to the markets that quote most aggressively. These order routers have by-passed the ITS which evolved in an era when the securities industry had under-invested in technology and broker-dealers needed an intermarket order routing system to fulfil their fiduciary obligation for best execution.

Moreover, technology has substantially enhanced the effectiveness of screen based trading through ECN's and other electronic networks. For example, options and futures trading on the Chicago exchanges is well on its way to full electronic trading. Competition from foreign markets has primarily driven these changes - not regulatory mandates.

The equity markets since 1975 have a far different profile with more proprietary trading by market professionals and larger institutional orders. Trading strategies of hedge funds and proprietary traders have become more complex where speed of execution may be far more important than price improvement.

There has been another significant change in the equity markets since the Congress mandated the NMS. Over the past decade the Commission has sought to improve the governance of the SRO's, particularly the NYSE and the NASD. Most recently, through prodding by the Commission, the NYSE has undergone a revolutionary change in its governance with a board composed only of independent directors - chaired by a respected outside chairman; its regulatory functions separated from its trading activities and reporting exclusively to the independent board; and, finally, a new chief executive offer determined to create a new trading model for the Exchange combining automated trading with the best of the floor based auction system to respond to the changing needs of its customers. The Commission has also brought a major enforcement action against the Exchange's specialist units to insure they meet their vital obligations for maintaining fair and orderly markets.

The NYSE has proven over many years to be a national asset with its enormous pool of liquidity. The Commission, despite its avowed policy to encourage competing markets, has implicitly recognized that fact. What's baffling about these proposals is that they pay little or no attention to these and other proposed reforms of the country's primary equity market.

By proposing voluntary depth of book protection for limit orders, the Commission takes a major step towards reshaping the equity markets by building them upon limit orders. The Release states that "[g]reater use of limit orders would increase market depth and liquidity, thereby improving the quality of execution for the large market orders of institutional customers." Running through the Release is the assumption that institutions with large orders want and need trading markets that encourage limit orders. It seems that these proposals have placed the Commission into a position - which it has usually avoided - of attempting to design an equity market on the basis of the interests of one class of investors and on the basis of an untested hypothesis.

Here are just some of the issues under the Commission's proposal that need to be explored in far more depth:

- Would protection for limit orders in all markets in fact encourage investors to place more limit orders? Specifically, would large institutional investors make greater use of limit orders or would they continue to seek to disguise their intentions?

- If more limit orders flow into a variety of market centers, would that improve the overall depth and liquidity of our markets or would it fragment them between large and small orders?

- What happens to the specialists' affirmative obligation to maintain fair and orderly markets? Under the Commission's proposal, who or what will maintain a fair and orderly market or reduce volatility at times of market stress?

In its long history, the Commission has not demonstrated an ability to resolve disputes among competing business interests in the securities industry and the securities markets. In fact, the Commission has wisely avoided favoring one type of investor, firm, market or business practice over another unless a matter clearly raised issues under the securities laws. It has left change primarily to the forces of competition, technology, investor preferences and other market factors. The unfixing of commission rates provides a good example. Over a period of fifteen years, the Commission prodded the industry through reports, studies and public hearings that change had to come and it facilitated that change when the NYSE finally unfixed all commission rates in May 1975. But the Commission did not use its statutory authority to order the change except when it was clear that the industry, the major exchanges and investors saw its inevitability.

Moreover, if the Commission approves this proposal, it will have taken on a major new task - overseeing the development and operation of a nationwide equity market for all publicly traded securities. In the past, the Commission has relied upon self-regulation and confined its role to one of prodding and oversight of market centers leaving management of a market to self-regulatory organizations or to private interests. This policy reflected a judgment in enacting the securities laws that a remote government agency should not be in the business of managing a trading market, requiring a multitude of decisions and judgments about market conduct. Does the Commission really want to get involved in such a major change in its role?

Finally, I offer several concluding observations and recommendations.

First, the Commission should not shelve the limit order protection proposal but rather ask the staff to do its homework. A time may come just as it did with the unfixing of commission rates when our equity markets must change dramatically under the combined influences of competitive forces, technological advances and investor and broker-dealer preferences. At this time, the Commission should adopt a "top of the book" limit order proposal for automated quotations. Second, the Commission should approve some form of the NYSE's hybrid market proposal which protects the best bid or offer and encourage the Exchange to continue to modernize its trading capabilities. The NYSE appears to have awakened to the need to change its trading model particularly to meet the needs of large institutional investors desiring speed and certainty of execution - even at the expense of possible price improvement.

But, the Commission should demand that the Exchange tighten restriction on market professionals on or off the floor who trade for their accounts or related accounts to deter the improper use of market information about impending trades. "Front running" and other abuses are inconsistent with the public interest in a fair and orderly public market that subordinates the interests of its professionals to those of the public.

I have no comment on the other three proposals, except to note that they represent appropriate rule making by the Commission to assure uniformity in market conduct across market centers.

Very truly yours.

Ralph S. Saul