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The Honorable William H. Donaldson
Chairman
U.S. Securities and Exchange Commission
450 Fifth Street, NW, Room 6000
Washington, DC 20549

S7-10-04

Dear Mr. Chairman:

As you know, I am very interested in the efforts of the Securities and Exchange Commission to alter the rules governing our National Market System. In light of the Commission's release last December of a revised regulatory proposal, I wanted to inform you of my views, consistent with all applicable laws and regulations, on these important matters.

It is, as I have highlighted in my previous correspondence, my very strong expectation that the Commission, first and foremost, will ensure that it protects the interests of average American retail investors in any decision it reaches regarding the future of the National Market System. I was therefore very pleased that the Commission decided to retain the trade-through rule when issuing its latest regulatory proposal.

As one of the foundations of our National Market System, the trade-through rule has ensured that all investors get the best price that our securities markets have to offer regardless of the location of a trading transaction. The approval of an opt-out provision for the trade-through rule would have likely splintered our securities markets, decreased liquidity, limited price discovery, and damaged our economy.

As I additionally understand, the Commission in its most recent regulatory proposal for updating the National Market System put forward two alternatives for maintaining the trade-through rule: the Market Best Bid or Offer Alternative and the Voluntary Depth Alternative. The former approach, in my view, is the one that the Commission should choose as it better protects investors, fosters competition between and within markets, and incentivizes markets to attract the most aggressive orders.

Many experts have already concluded that the Voluntary Depth Alternative is a one-size-fits-all approach that would hamper innovation and harm the competitiveness of U.S. equities markets. It also seems that the benefits of implementing the Voluntary Depth Alternative would likely accrue to institutional investors, rather than retail investors, and institutional investors are currently not generally asking for such a change in the securities markets.

Moreover, I am especially concerned that the Voluntary Depth Alternative is inconsistent with the goals of the National Market System in that it would undercut efforts to promote robust competition between markets. It would additionally almost certainly result in only one way for markets to differentiate themselves -- namely, how much they are willing to pay other market participants for their order flow. In my view, promoting competition based on payment for order flow will prove detrimental in the long term to average retail investors because of the conflicts of interest it creates.

At our hearings on market structure in the Capital Markets Subcommittee during the 108th Congress, I consistently cautioned everyone involved in these debates to move carefully and not to pursue change for change's sake. In other words, the Commission should not adopt any modifications to its rules unless it can clearly, unquestionably and without a doubt establish that such changes would represent an improvement over the existing regulatory framework for retail investors. The Voluntary Depth Alternative falls short of passing this simple test.

As you also stated in 2003 during your testimony before our panel, in pursuing any plan to fix those portions of the National Market System experiencing genuine strain, we must ensure that we do not disrupt those elements of our markets that are working well. It is therefore my sincere hope that the Commission in working to finalize any changes in the market-structure rules will first make certain that any regulation it promulgates will provide an improvement over the existing regulatory regime and protect the interests of retail investors.

The Securities and Exchange Commission can ultimately best ensure that investors obtain the best price by balancing competition between markets with protection of the best prices in each marketplace. From my perspective, the incremental approach contained in the Market Best Bid or Offer Alternative is preferable to the other alternative. The adoption of this incremental plan will protect investors by establishing a framework to ensure that they obtain the best price on their transactions, while at the same time ensuring they benefit from the forces of innovation and competition across markets. It will also help to ensure that the United States maintains its global leadership in our financial markets for many years to come.

In closing, I strongly encourage the Commission to adopt the Market Best Bid or Offer Alternative as quickly as possible and to reject the Voluntary Depth Alternative post haste. I would also ask that the Commission commence studying the problem of payment for order flow existing within our securities markets. Finally, please share my correspondence with your fellow commissioners and continue to keep me informed about the Commission's progress in examining our National Market System and studying the issue of payment for order flow.

Sincerely,

Paul E. Kanjorski

Paul E. Kanjorski
Ranking Member, Subcommittee on Capital Markets,
Insurance, and Government-Sponsored Enterprises

PEK/tmh