Deutsche Bank

Deutsche Bank Securities Inc.
Global Equities
60 Wall Street,
New York, NY 10005

Tel 1-212-250-2500

RECEIVED
FEB 04 2005
OFFICE OF THE SECRETARY

February 3, 2005

741

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

Re: File No. S7-10-04

Dear Mr. Katz:

Deutsche Bank Securities Inc. ("DBSI") appreciates the opportunity to submit comments to the Securities and Exchange Commission (the "Commission") regarding the reproposal of Regulation NMS (the "Reproposal").[1] DBSI commends the Commission for undertaking the important task of modifying the national market system framework established by Congress thirty years ago so that the common interests of investors and other market participants are advanced, fundamental protections are maintained, and efficiencies in trading are fostered through competition among marketplaces.

The Reproposal addresses four primary areas of equity market structure and would generally: (i) protect quotes by means of an intermarket trade-through prohibition, (ii) require fair access to markets, (iii) restrict quoting activities in sub-pennies, and (iv) revise the model for assessing and allocating market data fees. Our comments with respect to each area follow in order below.

I. The Trade-Through Rule

DBSI agrees with the Commission's position that limit orders are critically important to our markets, and we believe that readily accessible limit orders should be protected. In

[1] Securities Exchange Act Release No. 50870 (Dec. 16, 2004), 69 FR 77424 (Dec. 27, 2004).

our view, protection means that the first mover who commits to offer liquidity at a particular price point should be rewarded with the assurance that others in the marketplace cannot overlook that price and trade at an inferior price.

Our support for a trade-through rule is not absolute, and we believe its protections should only extend to quotations that are automated and immediately accessible. While the Commission has consistently endeavored to avoid policy decisions that intentionally pick winners and losers, the Commission should not afford trade-through protections to slow movers (i.e., quotes that are difficult to access or whose execution is not provided on an immediate basis) that stand as a roadblock to the efficient and speedy trading made possible by today's technology and communications systems.

Of the two proposed models set forth in the Reproposal, DBSI supports the Market BBO Alternative. DBSI believes that the Voluntary Depth Alternative, while admittedly not a mandatory mechanism, is the wrong approach and ultimately encourages a central mechanism that will inhibit competing business models and impose significant costs on market participants by requiring them to monitor many more quotes. We believe that one of the greatest strengths of the US equity markets is the ability of execution venues to compete on the basis of different services and opportunities. We believe that the Voluntary Depth Alternative would diminish the fierce but healthy competition for order flow among markets that presently generates varied and useful execution services.

While we support the Market BBO Alternative over the Voluntary Depth Alternative, we believe the Commission should carefully review the scope and full implications of the Market BBO Alternative, and, if necessary, make changes to ensure that an automated and immediately accessible quote representing the best intermarket price (and any reserve size attached to such quote) is assured priority in execution and cannot be skipped over by automated routers or algorithms.

II. The Access Rule

One of the pillars of a national market system that facilitates best execution of client orders is the requirement that markets provide market participants with fair and non-discriminatory access. We support the proposed requirement that markets must provide unbiased access to market participants seeking to access liquidity. A market should not be permitted to erect artificial barriers or impediments to persons wanting to legitimately tap into the market's available trading interest.

Private linkages among markets have shown great promise in light of improved connectivity technology. Private linkages also offer the additional benefits of avoiding a central mechanism that is likely to be weighed down by a cumbersome bureaucracy and alliances among governing members that are sometimes unproductive. But, even recognizing these advantages, the costs of developing and implementing a network of private linkages should be kept in mind.

We appreciate that the Commission is offering a compromise on the issue of access fees, and the approach appears to be a reasonable alternative to either banning access fees outright or permitting access fees with relatively high price caps. Additionally, we support the Commission's proposal to require self-regulatory organizations ("SROs") to take measures to avoid locked and crossed markets among their members. Pricing rationality is disrupted by locked and crossed markets, and efforts should be taken to reduce the incidence of such disruptions.

III. The Sub-Penny Rule

We support the Commission's proposal to restrict quoting activities in sub-penny increments. Academic studies and SRO analyses have established convincingly that decimalization has resulted in less liquidity at each individual price point. The consequence is that trading interest is more widely dispersed and more transactions are required to fill large orders. Additionally, the availability of numerous price points has resulted in more quote flickering, which makes it difficult for market participants to comply with tick-sensitive rules. Moreover, the economic commitment required to obtain price priority and thereby displace an earlier posted quote is minimal when compared to the economic commitment previously required to obtain price priority in the days of fraction-based pricing.

In our view, the availability of quotes out to three or four decimal places would greatly exacerbate and worsen the negative consequences that followed decimalization. When analyzed in terms of costs and benefits, we believe that the costs of sub-penny quoting (i.e., less liquidity at quotes, more transactions required to fill large orders, increased quote flickering, and increased ability to displace orders through minimal price improvement) far exceed any incremental benefits that market participants might enjoy through additional pricing conventions for their limit orders. Therefore, we believe that sub-penny quoting should not be permitted.

IV. The Market Data Rules

We appreciate the complex issues associated with market data fees, and we believe the Commission is right to bind the analysis of market data fees with a review of the structure of SROs. Market data revenues are a significant and important source of funding for the SROs. We believe it is appropriate that users of market data should pay fair and reasonable fees for their use of such data, and we acknowledge that users of market data effectively fund in part the mission of the SROs. We believe that unless the SROs are adequately equipped and resourced to perform their regulatory responsibilities in a competent manner, the quality and integrity of our markets will suffer and investors will lose trust and an incentive to transact. Those developments would in turn negatively impact the use of and demand for market data, creating a perverse cycle.

It is our view that enhanced transparency at the SRO level in terms of highlighting revenues taken in, as well as the costs of providing market data and the costs of delivering effective regulation, will greatly assist in determining what is a fair and reasonable fee for accessing and using market data. In short, we believe the use of market data revenues to support SRO functions is appropriate and necessary, but that the fees levied upon market data users should not be excessive such that they do not bear a reasonable nexus to the actual costs of providing market data and regulatory services.

In terms of the market data formula applied to transactions reported to the consolidated tape system, we believe that the formula should not reward suspect trading activity like trade shredding. The economic motive underlying a transaction should not be the prospect of sharing in market data revenues, and the Commission should put a stop to any approach that encourages such a practice.

V. A Word About Costs

The Commission has embarked upon an ambitious initiative to restructure the equity markets in a number of important and interrelated areas. If some or all of the Reproposal is adopted, market participants will face numerous practical challenges when implementing and observing the new rules. Therefore, when making any final determinations in this rulemaking effort, we respectfully ask the Commission to be mindful of the costs and burdens imposed on the broker-dealer community.

Specifically, what in principle may appear to be a rather straightforward measure, most assuredly involves significant changes to a broker-dealer's trading, technology, operations, supervisory and compliance platforms. For example, when the Commission adopted Regulation SHO in 2004, the Commission suggested in its cost-benefits analysis addressing threshold securities provisions that some concerns among commenters "may be exaggerated" and that some cost estimates "appear extremely speculative."[2] In our experience to date with Regulation SHO, which was a fairly incremental initiative that built upon existing SRO rules and adopted a fraction of the original Commission proposal, our costs (represented by hundreds of collective hours expended by DBSI Trading, Technology, Operations, Legal and Compliance personnel) have been real and significant. Moreover, because Regulation SHO became operative only as of January 3 of this year, we expect our costs to mount.

---

2 Securities Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008 (Aug. 6, 2004), at 69 FR 48026.

In sum, we are concerned that the adoption of Regulation NMS, unless carefully crafted with sensitivity to practical implementation difficulties and expenses, holds the potential to force upon broker-dealers complex challenges and burdensome costs, the scale of which may not be fully appreciated by the Commission.

VI. Conclusion

DBSI greatly appreciates the opportunity to share its perspectives with the Commission on this important proposal. We urge the Commission to consider the views offered by DBSI and to reach a determination that promotes the continued vitality and preeminence of the US equity markets. If you would like to discuss in greater detail the views of DBSI please contact me at (212) 250-4970.

Sincerely,

David Baker
Global Head of Cash Trading and Global Head of Portfolio Trading
Deutsche Bank Securities Inc.

cc: Chairman William H. Donaldson
Commissioner Paul S. Atkins
Commissioner Roel C. Campos
Commissioner Cynthia A. Glassman
Commissioner Harvey J. Goldschmid
Annette Nazareth, Director, Division of Market Regulation
Robert L.D. Colby, Deputy Director, Division of Market Regulation