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January 31, 2005

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

Re: File No. S-7-10-04 – Reproposal of Regulation NMS
Release No. 34-50870, 69 FR 77424 (December 27, 2004)

Dear Mr. Katz:

EWT, LLC ("EWT") welcomes the opportunity to offer our comments to the Securities and Exchange Commission ("Commission") on its revised Regulation NMS proposal. EWT commends the Commission for undertaking this important initiative and its careful consideration of the numerous and often conflicting comments it received on its initial proposal. We believe that the revised Regulation NMS proposal is a significant improvement over the initial proposal and, overall, will enhance investor protection and strengthen the national market system for stocks.

EWT is a professional trading firm whose principals have extensive experience trading stocks on multiple markets, including floor-based exchanges, Nasdaq, over-the-counter and ECNs, as well as foreign markets. The firm is a registered broker-dealer and a member of the NASD, as well as the New York Stock ("NYSE") and other exchanges.

Our comments relate to the two versions of a trade-through rule that the Commission has put on the table for comment. The Market BBO Alternative would generally require trading centers to provide price protection to the best displayed bid or offer ("BBO") of each exchange, the Nasdaq and the NASD ADF for an NMS stock if the quote is accessible for automated trading. The Voluntary DOB Alternative would extend this trade-through protection to automated depth of book ("DOB") quotations that are voluntarily displayed by a trading center pursuant to an effective national market system plan. The "trading centers" that would be subject to either rule include the exchanges,

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Nasdaq, exchange specialists, ECNs, OTC market makers and broker-dealers executing orders as principal or crossing orders as agent, and is intended to cover block positioners.

The Commission asks for comment on which of these two alternatives is "likely best to advance the principle of limit order protection while preserving intermarket competition and avoiding practical implementation problems." 69 FR 77427. Based upon our trading experience, we believe the answer is the Market BBO Alternative.

1. Why the Commission Should Adopt the Market BBO Trade-Through Rule

Will Achieve Objectives of a Trade Through Rule. A trade-through rule protecting displayed BBO quotes of SRO markets will advance the policy aims of a trade-through rule. It will promote investor confidence in the fairness of the U.S. equity markets by protecting limit orders reflected in the BBO quotations displayed by the SROs against trade-through and protecting market and marketable limit orders against trading at prices inferior to those displayed best quotations. By protecting BBO quotations, the rule should encourage investors to use limit orders, leading to increased market depth, liquidity and efficiency.

Positive Impact on Intermarket Competition. The Market BBO Alternative will also preserve and enhance intermarket competition. It will accommodate different trading models, allowing markets to continue to compete for order flow on the basis of the services they provide (e.g., negotiated floor auctions, speedy automated trade execution, ability to handle complex orders), the depth and liquidity of their markets and trading costs. Over the years, the markets have benefited from this intermarket competition in the form of more efficient trading systems and trading innovations, such as the NYSE's plans to implement a hybrid floor-auction/electronic market. Importantly, the Market BBO trade-through rule will promote competition among the markets to attract aggressively priced limit orders, at the same time furthering the separate national market system policy of promoting competition among orders through interaction of orders across market boundaries.

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Practical To Implement. The Market BBO Alternative should be practical to implement. Private linkages are already in place connecting the various markets where many NMS stocks trade. Many broker-dealers also have "smart" order routing systems that analyze quotations and automatically route orders in accordance with various factors. We believe the industry can build upon these existing systems to implement BBO price protection without undue cost.

2. Why the Commission Should Reject a DOB Trade-Through Rule

EWT urges the Commission to reject the DOB version of the trade-through rule, for the following reasons.

Won't Achieve Objectives of a Trade Through Rule. We believe that a DOB trade through rule will achieve the opposite of the intended benefits of a trade-through rule. Moreover, the Commission has not identified any problems caused by the absence of this type of rule that would justify imposing such an extraordinary structural change on our public equity markets.

The underlying problem, as the Commission explains in its release, is that the reserve size function available in electronic markets will cause trade-throughs to occur when an incoming order executes against undisplayed reserve size before reaching the targeted quote at the next price level. Because reserve orders are a common element in our equity markets, we anticipate that trade-throughs will be a common occurrence under a DOB trade-through rule. Many investors, though, will reasonably but incorrectly assume that the rule protects all limit orders. This disconnect between practice and expectation will breed confusion and distrust. Investors whose orders are by-passed due to reserve size trading ahead of them will likely conclude that they have been treated unfairly, discouraging their use of limit orders and depriving the markets of the depth and liquidity that limit orders provide.

Substantial Negative Impact on Intermarket Competition. We agree with the Commission that the predominantly electronic markets for Nasdaq stocks and the dominant NYSE floor market for NYSE-listed stocks each "have significant strengths" as well as "weaknesses that could be reduced by strengthened protection against trade-throughs." 69 FR 77432. Thus, like the Commission, we believe it is important for any

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trade-through rule it adopts to accommodate different types of market structures for all NMS stocks, so that investors will continue to have a choice as to the trading model they prefer based on the varying strengths and weaknesses that each offers. In this way, the competitive dynamic of investor choice will drive market efficiencies and trading innovations.

A DOB trade-through rule, though, does not accommodate different market models. Instead, such a rule will transform the national market system into a loosely integrated electronic order routing and matching system, akin to a nationwide ECN (but with the inefficiencies of its piecemeal design). After one market decides to disseminate and provide automated access to its DOB quotes, many other markets will surely follow suit, for defensive reasons if no more, to assure their customers that their limit orders qualify for the same intermarket price protection. Once automated DOB quotations are protected across markets, markets can no longer set themselves apart on the basis of market depth, liquidity and trading efficiency. The competitive value of each market's depth of book will all but disappear, and along with it the incentives that markets have today to attract that liquidity through enhanced trading efficiencies and trading innovations.

A DOB trade through rule has potentially dire ramifications for the NYSE floor-auction, where over 80% of the shares in NYSE-listed stocks are traded efficiently at competitive prices. Specialists will have to redirect their primary trading focus away from the floor auction to actively manage their limit order books externally against DOB quotes of other markets and route orders to those markets. This will disrupt the smooth functioning of the floor auction and will make it difficult for specialists to handle and price large block-sized orders. In addition, specialists and floor brokers will likely feel compelled to display their customers' limit orders and make such orders available for automated trading through Direct+ to secure some measure of intermarket trading parity for such orders, with the specialists and brokers relinquishing the human trading skills and judgment they exercise today on behalf of customer orders. In short, there is a very real risk that a DOB trade-through rule will push the NYSE floor-auction out of existence as it becomes absorbed into an all electronic market structure.

Similarly, the proposed DOB trade-through rule will undercut the NYSE's hybrid market initiative. As an NYSE member firm, EWT is pleased that the NYSE has

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responded to customer demand for greater automated trading access to the Exchange's published quotations, but in a creative way that seeks to preserve and blend the proven advantages of its negotiated floor auction – efficient pricing and the ability to fill large orders – with the speed of automated trade execution. We support the hybrid market and believe the NYSE's well thought out design will, given the opportunity, prove to be a successful trading alternative to electronic only markets. We do not see how the hybrid market has any real chance for success, though, under a trade-through rule that will interfere with the operation of the auction component of this ambitious trading structure. The NYSE, in fact, has stated publicly that it could not operate the hybrid market if the Commission adopts the DOB trade-through rule.

Impractical and Costly to Implement. The DOB trade-through proposal is impractical, both because it will lead to market inefficiencies and will be costly to implement. Under a DOB trade-through rule, all trading centers – exchanges, Nasdaq, specialists, ECNs, OTC market makers, block positions and other broker-dealers – will have to develop their own systems to monitor constantly changing quotations at multiple price levels on multiple markets. These systems will have to route orders blindly to other markets, where they will often go unfilled as multiple orders attempt to trade against the same protected quotes because they have to pursuant to Commission edict. Large orders will be difficult to execute in this environment and will have to be divided into smaller pieces for simultaneous routing to attempt to trade against quotes across various markets. The ability for a trading center to route immediate or cancel orders won't overcome these serious market inefficiencies. By the time an unfilled order is returned to the originating trading center, the order may well have missed the market at that trading venue, resulting in a worse fill than it would have received had it not been sent away or, for limit orders that are no longer marketable, resulting in loss of priority within the trading center to same priced orders that arrived during the unfilled order's round-trip misadventure.

In addition, SRO markets and other trading centers will incur enormous hard dollar costs to develop and maintain the systems necessary to meet their responsibilities under a DOB trade-through rule – and without any offsetting benefits. Although these costs are difficult to quantify without detailed input from those who will have to bear the brunt of these costs, one can begin to appreciate the massive financial commitment involved by identifying the systems that will need to be developed or modified. For example, the computer systems for processing and disseminating quotations under the existing market data plans will require substantial upgrade. The transmission lines used by the plans' processors, as well as the transmission lines used by market data vendors, will require potentially significant capacity upgrades to handle what may well be exponential increases in quote message traffic.

In addition, trading centers will have to develop the systems to identify protected quotes at multiple price points on multiple markets and the functionality to route orders automatically to those protected quotes when required to meet their responsibilities under a DOB trade-through rule. Trading centers will also have to develop audit trail functionality. In the reproposing release, the Commission states that trading centers will have to "implement clock synchronization practices" as an "essential procedure" to deal with "'clock drift' and time lags between different data sources." 69 FR 77437 n. 90. While this is true under both of the trade through rule proposals, the higher quote messaging traffic under the DOB proposal will make audit trail systems all the more complicated, and costly, to develop. Any trading center that wants the ability to use the proposed "self-help" exemption to by-pass trading centers with a pattern of failing to respond within 1 second to incoming orders will need some mechanism to access and keep records of the time stamps generated by other markets when they receive and when they respond to the routing market's orders. This, too, will be much more complicated and costly to develop under the DOB alternative.

The industry will probably incur material developmental costs in other areas, and there will be ongoing operational costs as well. If the Commission is inclined to adopt a DOB trade-through rule, it is imperative that the Commission conduct a thorough cost-benefit analysis before reaching its final decision.

3. Conclusion

EWT supports the Market BBO trade-through rule. This version sets out a practical approach for protecting limit orders against trade-through and promoting execution of market and marketable limit at the best displayed prices, which should promote investor confidence in the fairness of the public equity markets and encourage investors' use of limit orders. This rule will also promote competition among market centers, furthering another important policy objective of the national market system. The proposed DOB trade-through rule, in contrast, will not achieve the Commission's stated objectives;

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moreover, it will be costly to implement, will undermine intermarket competition by mandating an electronic-only market structure and will create serious market inefficiencies. Accordingly, we recommend that the Commission adopt the proposed Market BBO trade-through rule.

Sincerely,

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