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January 24, 2005

Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Proposed Regulation NMS, File No. S-7-10-04

Dear Mr. Katz:

The Interactive Brokers Group[1], on behalf of its affiliates Timber Hill LLC and Interactive Brokers LLC, respectfully submits these comments on the Commission's amended proposed Regulation NMS. We strongly support adoption of proposed Reg NMS, which is a common sense and long-overdue update of the national market system rules in light of the major technological changes that have taken place in the equity markets in the last three decades.

We focus our comments here on the Commission's proposed Order Protection ("trade-through") Rule. We support adoption of the Market BBO Alternative proposed by the Commission, under which investors will be guaranteed to receive the best electronically executable price displayed in the national market system. However, we do not believe that the Voluntary Depth Alternative, under which a market center executing an order would have to protect or satisfy all displayed quotes in every other market center's book, is necessary, and we believe that the complexity of implementing and enforcing the Voluntary Depth alternative at the exchange level would outweigh its benefits. Rather, the Commission should emphasize each

[1] Interactive Brokers Group is among the twenty largest securities firms in the U.S. Our subsidiary Interactive Brokers LLC provides smart routing and direct access online brokerage services to thousands of institutions and sophisticated individual customers. Our market making affiliate, Timber Hill LLC, is one of the most active market making firms in options and other equity derivatives and is among the largest users of the U.S. stock exchanges. IB Group companies trade on Nasdaq, all the major ECNs and on the New York Stock Exchange, where IB LLC is a member and is among the top 15 program trading firms.

broker's duty to use readily available order-by-order routing systems to access displayed liquidity at multiple price levels across many markets for each order they handle. Enhanced use of smart routing technology, combined with the backstop of the top-of-book best price protection that market centers will enforce under Reg NMS, is a workable compromise that will provide an appropriate level of customer protection without imposing an excessive regulatory or linkage burden on exchanges.

The Commission and its staff have developed the Reg NMS proposal slowly and deliberately after many, many months of informal discussions with the industry, public meetings, roundtables, formal requests for comment and other consultation. It is now time for the Commission to Act and to approve Reg NMS. We discuss these matters in more detail below.

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Reg NMS is meant to address several fundamental issues facing market participants when trying to execute stock trades across the many exchanges and other trading venues that now exist in the national market system. Chief among these is that, although market centers are supposed to fill orders at whatever price is displayed to the public at the time, manual, floor-based exchanges often fail to honor their advertised prices. On the other hand, orders sent to ECNs and exchange automatic execution systems are immediately executed at the displayed quote. Notwithstanding this profound difference between manual and automatically accessible quotes, outdated Intermarket Trading System rules require brokers and electronic market centers to send orders to slow, floor-based markets if those markets are posting the best price -- even though the certainty of getting a fill is much lower than on an electronic system (indeed, the chance of getting a fill on a traditional exchange goes down when the market is moving in favor of the customer's order, exactly when the customer most needs a quick fill).

Under the BBO Alternative of the Reg NMS Order Protection Rule, market centers will have to indicate, in each of their price quotes, whether an order sent to trade against that quote will be executed immediately, or whether manual handling will be required. If a particular market's best quote is the best price available across the nation's markets, and is immediately, electronically executable, brokers should send their customers' orders to that quote, and other markets cannot trade at prices that would be worse for a customer than that national best price. On the other hand, if a market's price is not truly firm (if it is a "manual quote" that involves human discretion in the execution process), brokers will be allowed to bypass that market and execute a customer's order on an electronic market at a "worse" – but true -- price.

By requiring markets to indicate whether their best price truly is firm (electronically executable), and by requiring brokers and exchanges to honor the best national electronically executable quote, the BBO Order Protection Rule of Reg NMS will accomplish three goals. First, customers will be assured of getting the best national price for their stock orders, and with the highly advanced smart order routing technology available today, there is simply no excuse for anything less. Second, professional market makers and other liquidity providers who *post* their quotes on electronic markets (i.e., who advertise their willingness to trade at a particular price with the public), will be assured that other markets cannot ignore those quotes and execute orders at inferior prices. Knowing that they will capture customer stock trading business if they are quoting the best national price encourages market makers to post firm, competitive quotes, which are the lifeblood of transparent and liquid capital markets. Finally, Reg NMS effectively supercedes the outmoded ITS trade-through rule, which in certain cases requires that customer orders in exchange-listed stocks be sent to slow, manual markets, even though such markets may show the best price but frequently execute at a worse price (this rule has acted as a subtle disincentive for traditional exchanges to automate their operations).

While we support the BBO Alternative of the Order Protection rule, we do not believe that it would be wise to require exchanges to protect all displayed bids and offers down the books of other exchanges (the “Voluntary Depth Alternative”). Rather, we think it should be left to broker-dealers, pursuant to their duty of best execution, to use readily available order by order routing systems to access deep book liquidity offered across multiple market centers for each order the broker-dealer handles.

Requiring market centers to honor tens, hundreds or thousands of constantly changing quotes in the deep books of all of their competitors would make it much more difficult for them to comply with the Order Protection rule, and potentially would reduce existing market centers to mere entry portals into a monolithic linkage system that they would have to build and administer. The continued viability of multiple, competing marketplaces would be in question in this system and it is not clear that these marketplaces would have the incentive or resources to continue to develop new systems, products, technologies or services. Likewise, a single, exchange administered linkage system would create a single point of failure in the national market system and would be susceptible to delays and outages. Finally, like the current ITS system, the rules, procedures and technology platform of such a linkage would be inflexible and resistant to change.

The Commission instead should state clearly that broker dealers have an obligation, pursuant to their duty of best execution, to use available technology to access the best posted prices – including displayed prices down available market centers’ books – for *each order* they handle. If no single market was posting sufficient size at the NBBO to execute a customer’s order, the broker-dealer would divide the order across markets in order to optimize aggregate execution price and speed. On the other hand, a broker that simply routes every order to a single market center for execution on that market center’s book, without regard to readily accessible automated quotes in the deep books of other market centers, would not be considered to be acting reasonably and in the best interest of the customer.

Placing the burden on the broker to execute large or complex orders across multiple markets is much more consistent with the traditional understanding of the broker’s role and agency obligations than would placing such burden on the exchanges. Moreover, order-by-order smart routing technology that can examine the deep books of multiple market centers and route customer orders or pieces of orders to those market centers is readily available. Finally, emphasizing the broker’s duty to route each order individually based on the displayed quotes in market centers' limit order books would not require the wholesale creation of a new linkage system, would not undermine or threaten existing exchanges or ECNs or deprive them of any incentive for continued competition, and would create redundant, parallel routing capacity by virtue of the many different systems that would be offered by competing brokers and vendors.

It is not that automatically executable orders in the deep books of market centers should not be protected from being traded through – they *should* be protected, but that protection should result from an enhanced emphasis and understanding that broker-dealers have an obligation when representing their customers' orders to access these deep-book quotes. The obligation should be on the broker and not on other exchanges.

In sum, relying primarily on broker-dealer smart routing systems to access the best-priced quotes across and down the books of multiple market centers, combined with the "back-up" protection provided by the Reg NMS BBO trade-through rule (under which the market center will also assure that the customer will not be executed at a price worse than the NBBO for the applicable number of shares) seems to be a reasonable compromise that offers appropriate protection to customers and to liquidity providers while avoiding the problems inherent in a CLOB-like system.

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While the Commission's update of the national market system rules should cause the salutary effects discussed above, Reg NMS does not dictate winners and losers or mandate a particular structure for the national trading system. For example, Reg NMS does not require markets to become electronic. To the extent that floor markets with human intermediated auctions add value in the order execution process, especially for block-sized or complex orders, those markets will continue to flourish. In short -- market forces will determine how orders for various types of market users, from small investors to large hedge funds, will be handled and executed.

The problems with the current Intermarket Trading System and the principles behind proposed Reg NMS have been discussed and debated for years now. We recommend that the Commission take action and approve Reg NMS.

We thank the Commission and its staff for their time and consideration of our comments. Please contact either of the undersigned if you require any additional information or would like to discuss these matters further.

s/ Thomas Peterffy

Thomas Peterffy
Chairman

s/ David M. Battan

David M. Battan
Vice President

cc: Hon. William H. Donaldson
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