

**TESTIMONY OF KIM BANG,  
PRESIDENT AND CHIEF EXECUTIVE OFFICER  
BLOOMBERG TRADEBOOK LLC,  
BEFORE THE SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE,  
AND GOVERNMENT SPONSORED ENTERPRISES OF THE COMMITTEE ON  
FINANCIAL SERVICES,  
U.S. HOUSE OF REPRESENTATIVES,  
REGARDING  
“THE SEC’S MARKET STRUCTURE PROPOSAL: WILL IT ENHANCE  
COMPETITION?”  
FEBRUARY 15, 2005**

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE. MY NAME IS KIM BANG, AND I AM PLEASED TO TESTIFY ON BEHALF OF BLOOMBERG TRADEBOOK REGARDING “THE SEC’S MARKET STRUCTURE PROPOSAL: WILL IT ENHANCE COMPETITION?”.

BLOOMBERG TRADEBOOK IS OWNED BY BLOOMBERG L.P. AND IS LOCATED IN NEW YORK CITY. BLOOMBERG L.P. PROVIDES MULTIMEDIA, ANALYTICAL AND NEWS SERVICES TO MORE THAN 200,000 TERMINALS USED BY 250,000 FINANCIAL PROFESSIONALS IN 100 COUNTRIES WORLDWIDE. BLOOMBERG TRACKS MORE THAN 135,000 EQUITY SECURITIES IN 85 COUNTRIES, MORE THAN 50,000 COMPANIES TRADING ON 82 EXCHANGES AND MORE THAN 406,000 CORPORATE BONDS. BLOOMBERG NEWS IS SYNDICATED IN OVER 350 NEWSPAPERS, AND ON

550 RADIO AND TELEVISION STATIONS WORLDWIDE. BLOOMBERG PUBLISHES MAGAZINES AND BOOKS ON FINANCIAL SUBJECTS FOR THE INVESTMENT PROFESSIONAL AND NON-PROFESSIONAL READER.

BLOOMBERG TRADEBOOK IS A GLOBAL ELECTRONIC AGENCY BROKER SERVING INSTITUTIONS AND OTHER BROKER-DEALERS. WE COUNT AMONG OUR CLIENTS MANY OF THE NATION'S LARGEST INSTITUTIONAL INVESTORS REPRESENTING — THROUGH PENSION FUNDS, MUTUAL FUNDS AND OTHER VEHICLES — THE SAVINGS OF MILLIONS OF ORDINARY AMERICANS.

BLOOMBERG TRADEBOOK SPECIALIZES IN CONSOLIDATING WHAT HAS BEEN A FRAGMENTED MARKET BY INCREASING TRANSPARENCY AND ACCESS TO LIQUIDITY ACROSS COMPETING MARKET CENTERS.

**I. THE UNDERLYING ISSUE DRIVING REG NMS IS THE NEAR MONOPOLY THE NYSE ENJOYS OVER THE TRADING VOLUME IN ITS LISTED SECURITIES**

THE HOUSE FINANCIAL SERVICES COMMITTEE HAS LONG UNDERSTOOD HOW SEEMINGLY ABSTRACT MARKET STRUCTURE ISSUES HAVE A DIRECT BEARING ON THE EFFICIENCY AND COMPETITIVENESS OF OUR MARKETS AND THE INTERESTS OF INVESTORS. THE COMMITTEE'S INTEREST IN THE SEC'S REGULATION NMS PROPOSAL IS WELCOME AND WARRANTED.

PROPOSED REGULATION NMS IS AN AMBITIOUS EFFORT TO ENGAGE POLICY MAKERS, MARKET PARTICIPANTS AND THE PUBLIC IN A DEBATE OVER HOW BEST TO PROMOTE THE LONG-OVERDUE MODERNIZATION OF THE U.S. EQUITY MARKETS.

MARKET PARTICIPANTS AND POLICY MAKERS HAVE OFTEN ASKED “WHY DOES THE NYSE CONTROL 80 PERCENT OF THE TRADING VOLUME OF ITS LISTED COMPANIES WHEN NASDAQ CONTROLS ONLY ABOUT 20 PERCENT OF THE VOLUME OF ITS LISTED COMPANIES?” THE ANSWER IS SIMPLE — REGULATORY BARRIERS TO COMPETITION. IF THE BARRIERS ARE REMOVED AND INVESTORS AND FIDUCIARIES THEN FREELY CHOOSE TO SEND THEIR ORDERS TO THE NYSE, THAT WOULD BE THE RESULT OF FREE COMPETITION AND INVESTOR CHOICE, FACTORS NOT CURRENTLY PRESENT.

## **II. THE OTC MARKET AS A MODEL FOR A COMPETITIVE MARKET**

THE NASDAQ MARKET SINCE 1996 PRESENTS THE OPPOSITE PICTURE — IT IS A MARKET INTO WHICH REGULATION INTRODUCED AND ENCOURAGED COMPETITION. THE NASDAQ PRICE-FIXING SCANDAL OF THE MID-1990S RESULTED IN THE SEC’S 1996 ISSUANCE OF THE ORDER-HANDLING RULES. THOSE RULES ENHANCED TRANSPARENCY AND COMPETITION IN THE NASDAQ MARKET AND PERMITTED ELECTRONIC COMMUNICATIONS NETWORKS — ECNS — TO LEVEL THE PLAYING FIELD BETWEEN INVESTORS AND INTERMEDIARIES BY

GRANTING INVESTORS DIRECT MARKET ACCESS TO THE NATIONAL MARKET SYSTEM.

INDEED, THE INCREASED TRANSPARENCY PROMOTED BY THE SEC'S ORDER-HANDLING RULES AND THE SUBSEQUENT INTEGRATION OF ECNS INTO THE NATIONAL QUOTATION MONTAGE NARROWED NASDAQ SPREADS BY NEARLY 30% IN THE FIRST YEAR FOLLOWING ADOPTION OF THE ORDER-HANDLING RULES. THESE, AND SUBSEQUENT REDUCTIONS IN TRANSACTIONAL COSTS, CONSTITUTE SIGNIFICANT SAVINGS THAT ARE NOW AVAILABLE FOR INVESTMENT THAT FUELS BUSINESS EXPANSION AND JOB CREATION.

THE QUESTION CONFRONTING THE SEC AND THE CONGRESS IS WHETHER OUR MARKETS IN LISTED SECURITIES CAN BE REFORMED TO BRING THE SAME BENEFITS TO THE NYSE INVESTOR AS THEY HAVE TO THE NASDAQ INVESTOR. NOW THAT THE NYSE HAS BEEN FORCED TO GIVE UP ITS RULE 390 (RESTRICTING ORDER FLOW TO THE OTC MARKET) AND RULE 500 (RESTRICTING THE ABILITY OF LISTED COMPANIES TO DELIST), THE EXISTING TRADE-THROUGH RULE REMAINS THE FOREMOST IMPEDIMENT TO COMPETITION AND MARKET EFFICIENCY.

**III. THE TRADE-THROUGH RULE HAS HISTORICALLY FUNCTIONED  
AS PROTECTIONIST REGULATION**

THE TWENTY-YEAR-OLD TRADE-THROUGH PROVISION OF THE INTER-MARKET TRADING SYSTEM PLAN STATES THAT WHEN THE SPECIALIST OR MARKET MAKER RECEIVES AN ORDER, IT CANNOT EXECUTE IT AT A PRICE INFERIOR TO ANY FOUND ON ANOTHER MARKET WITHOUT GIVING A “FILL” TO THE BETTER-PRICED ORDER. BUT THERE IS A GAP BETWEEN THE RULE’S PRINCIPLE AND ITS PRACTICE. UNDER THE RULE, ORDERS ARE NOT PROTECTED SO MUCH AS THEY ARE UNFAIRLY EXPLOITED.

CONSIDER, FOR EXAMPLE, THE AMERICAN STOCK EXCHANGE. BLOOMBERG TRADEBOOK CLIENTS GENERALLY AVOID THE AMEX. THEY DO SO BECAUSE AMEX QUOTATIONS ARE INDICATIVE ONLY — NOT FIRM — AND TAKE 10 TO 15 SECONDS TO BE FILLED OR REJECTED. IN TODAY’S ELECTRONIC MARKETS, IN WHICH MARKETS MOVE IN MILLISECONDS, A DELAY OF 10 TO 15 SECONDS IS AN ETERNITY.

INVESTORS, FIDUCIARIES AND MARKET PARTICIPANTS FACE THE SAME PROBLEM WITH THE NYSE WHEN THE SPECIALIST DISPLAYS AN INDICATIVE PRICE, WHICH IS NOT A BINDING ONE. A MARKET PARTICIPANT SENDING TO THE NYSE MANUAL MARKET A MARKETABLE LIMIT ORDER (THAT IS, AN ORDER AT A PRICE EQUAL OR BETTER THAN THE ADVERTISED QUOTATION) OFTEN FINDS THAT THE ORDER IS HELD UP

AND NOT EXECUTED FOR AN AVERAGE OF MORE THAN 20 SECONDS WHILE THE SPECIALIST GOES THROUGH THE AUCTION PROCESS. DURING THAT PROCESS, THE ORDER MAY BE REJECTED, OR FILLED AT A PRICE INFERIOR TO THE ADVERTISED PRICE.

WHILE THIS AUCTION PROCESS IS GOING ON, THE SPECIALIST HAS A FREE OPTION. UNTIL HE COMMUNICATES AN EXECUTION OR REJECTION, THE ORDER ENTRANT CANNOT EFFECTIVELY DRAW THE ORDER BACK OR MODIFY IT. INVESTORS, IN EFFECT, GRANT A FREE OPTION TO THE SPECIALIST WITH EVERY MANUAL ORDER. THAT'S HOW THE SPECIALISTS PROSPER, PARTICULARLY GIVEN THE MONOPOLIES THEY ENJOY. INVESTORS THEREBY INCUR AN OPPORTUNITY COST AND THE SPECIALIST GAINS THE ADVANTAGE. IN THE MEANTIME, THE MARKET OFTEN MOVES.

THE CLEAR DISADVANTAGE TO INVESTORS IS NOT ONLY IN HAVING THEIR ORDERS HELD UP ON AMEX OR THE NYSE, BUT ALSO IN BEING DEPRIVED OF PRICING OPPORTUNITIES REPRESENTED IN OTHER MARKETS. WHAT IS NEEDED IS GIVE TO INVESTORS THE CHOICE OF MARKET VENUE, WITH OR WITHOUT BROKER INTERMEDIATION. INVESTOR CHOICE IS THE CORNERSTONE OF FREE AND COMPETITIVE MARKETS.

**IV. THE CURRENT TRADE-THROUGH RULE  
DOES NOT PROTECT INVESTORS**

WE SHARE WITH SINCERE PROPONENTS OF TRADE-THROUGH RULES A VISION OF A NATIONAL MARKET SYSTEM THAT PROMOTES TRANSPARENCY AND ACCESS TO LIQUIDITY AND LEVELS THE PLAYING FIELD BETWEEN INVESTORS AND INTERMEDIARIES. WERE A TRADE-THROUGH RULE EFFECTIVE AND NECESSARY TO ACHIEVE THESE ENDS, WE WOULD SUPPORT IT WITHOUT RESERVATION.

THE REALITY, HOWEVER, IS THAT THE EXISTING TRADE-THROUGH RULE DOES NOT PROVIDE ANY MEANINGFUL INVESTOR PROTECTION. IT IS, INSTEAD, AN IMPEDIMENT TO ACHIEVING BEST EXECUTION. IT HAS STOOD IN THE WAY OF INNOVATION AND COMPETITION.

**V. SHOULD THE TRADE-THROUGH RULE BE MADE A FEDERAL  
LAW EXTENDED TO ALL STOCKS?**

MUCH OF THE IMPETUS FOR MARKET REFORM HAS BEEN DRIVEN BY THE INDUSTRY-WIDE CONSENSUS THAT THE NYSE NEEDED TO MODERNIZE — A CONSENSUS GIVEN INCREASED IMPETUS BY LAST YEAR'S SPECIALIST SCANDALS IN WHICH SEVEN SPECIALIST FIRMS AGREED TO PAY ALMOST \$250 MILLION TO SETTLE AN SEC PROBE INTO ALLEDGED TRADING ABUSES. WE DON'T BELIEVE THAT EXTENDING THE

TRADE-THROUGH RULE TO THE OTC MARKET IS THE BEST WAY TO ACHIEVE MEANINGFUL CHANGE IN THE NYSE. JUST BECAUSE THE NYSE IS IN NEED OF SOME STERN MEDICINE DOESN'T MEAN OTHERS HAVE TO TAKE IT AS WELL.

WE WOULD RESPECTFULLY SUBMIT THAT THE GOALS OF THE NATIONAL MARKET SYSTEM CAN BE MOST FULLY AND EFFECTIVELY REALIZED WITH GREATER TRANSPARENCY AND UNINTERMEDIATED ACCESS TO FIRM QUOTATIONS. GREATER MANDATORY DISPLAY OF LIQUIDITY BEYOND THE NATIONAL BEST BID AND OFFER (“NBBO”) AND IMMEDIATE ELECTRONIC ACCESS WOULD MAKE FOR A BETTER, MORE COMPETITIVE NATIONAL MARKET SYSTEM. MARKET PARTICIPANTS HAVE IMPLEMENTED EXECUTION-MANAGEMENT SYSTEMS, INTER-MARKET CONNECTIVITY AND SMART ORDER-ROUTING SYSTEMS THAT ENABLE THEM TO SEEK BEST EXECUTION FOR THEIR CLIENTS.

WE THINK THOSE TECHNOLOGIES PROVIDE THE BASIS FOR A MORE EFFICIENT AND COMPETITIVE MARKET. WE BELIEVE THAT IN PART BECAUSE FIDUCIARIES COULD NOT — AND WE BELIEVE WOULD NOT — IGNORE WITH IMPUNITY INFORMATION RIGHT IN FRONT OF THEM ABOUT HOW TO ROUTE THEIR ORDERS TO THE BEST PRICES. ECONOMIC SELF-INTEREST, COUPLED WITH COMPETITION TO MAXIMIZE PORTFOLIO PERFORMANCE, WOULD DO MORE THAN HEAVY-HANDED

GOVERNMENTAL REGULATION AIMED AT DICTATING ORDER-ROUTING PRIORITIES.

**VI. THE STUDY PUBLISHED BY THE COMMISSION  
IN SUPPORT OF A TRADE-THROUGH RULE IS SERIOUSLY FLAWED<sup>1</sup>**

THE ARGUMENTS FOR A TRADE-THROUGH RULE IN THE OVER-THE-COUNTER MARKET IN NASDAQ SECURITIES ARE WEAKER STILL. THE SEC'S OFFICE OF ECONOMIC ANALYSIS (OEA) TRADE THROUGH STUDY SEEKS TO COMPARE TRADE THROUGHS IN NASDAQ SECURITIES WITH TRADE THROUGHS IN EXCHANGE-LISTED SECURITIES. WHILE THE OEA IS TO BE COMMENDED FOR ITS EFFORTS, WE BELIEVE IT MAY HAVE SIGNIFICANTLY OVERESTIMATED THE INCIDENCE OF TRADE THROUGHS IN THE OTC MARKET. THAT OVERESTIMATION MAY HAVE ARISEN BOTH BECAUSE OF METHODOLOGICAL SHORTCOMINGS IN THE STUDY — PARTICULARLY ITS FAILURE TO CONSIDER “RESERVE” AND “REPLENISHMENT” FUNCTIONS AND ITS OVERSTATEMENT OF INVESTOR IMPACT — AND BECAUSE OF CHANGES IN THE OTC MARKET SINCE THE STUDY WAS COMPLETED.

**RESERVE.** THE MOST PROMINENT OF THE METHODOLOGICAL SHORTCOMINGS IS THE FAILURE TO ACCOUNT FOR HOW THE ECN'S RESERVE AND REPLENISHMENT FEATURES MAY INACCURATELY HAVE

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<sup>1</sup> See, “Analysis of Trade-throughs in Nasdaq and NYSE Issues,” Memorandum to File from SEC Office of Economic Analysis (December 15, 2004) (the “OEA Trade Through Study”).

BEEN PERCEIVED AS TRADE THROUGHES. THE OEA TRADE-THROUGH STUDY DID NOT CONSIDER THE IMPACT OF RESERVE AND REPLENISHMENT. AS A RESULT, THE TRADES COUNTED AS TRADE THROUGHES WERE IN MANY CASES FALSE POSITIVES. THAT DISTORTED THE DATA AND THE STUDY'S CONCLUSIONS. THESE DISTORTIONS OCCURRED BECAUSE THE STUDY USED A THREE-SECOND "WINDOW" FOLLOWING A TRADE AS THE MEASUREMENT OF WHETHER A TRADE-THROUGH OCCURRED. THAT WINDOW IGNORED THE EFFECT ON MANY ECNS OF RESERVE, IN WHICH UNDISPLAYED QUANTITIES LIE BELOW THE DISPLAYED QUANTITIES AND, WHEN A DISPLAYED QUANTITY IS EXHAUSTED, PART OR ALL OF THE RESERVE POPS UP IN ITS PLACE WITHIN A FRACTION OF A SECOND. THE THREE-SECOND WINDOW USED BY THE OEA TREATED THE POP UP AS IF IT WERE THERE ALL ALONG, MISCHARACTERIZING IT AS HAVING BEEN TRADED THROUGH.

**INADVERTENT OVERSTATEMENT OF INVESTOR IMPACT.**

THE OEA STUDY HAS ANOTHER FLAW. IN MEASURING THE IMPACT OF TRADE-THROUGHES, IT RELIES IN PART ON A CLEARLY ERRONEOUS METHOD OF COUNTING THE VOLUME OF A TRADE-THROUGH. FOR EXAMPLE, WHERE A TRANSACTION TRADES THROUGH A 500-SHARE ORDER, THE TRADE THROUGH SHOULD BE COUNTED AS 500 SHARES, NOT THE POSSIBLY MUCH GREATER SIZE OF THE TRANSACTION THAT TRADED THROUGH 500 SHARES — IT COULD HAVE BEEN 5,000 SHARES, 50,000 SHARES OR WHATEVER. THE STUDY USES BOTH APPROACHES IN

MEASURING TRADE THROUGHES. BY ONE MEASURE, USING THE CORRECT APPROACH, THE TRADE THROUGH INCIDENCE WAS STATED TO BE 1.7% OF NASDAQ SHARE VOLUME (WHICH WAS ITSELF OVERSTATED GIVEN THE OTHER CALCULATION PROBLEMS SUCH AS THE EFFECT OF RESERVE AND REPLENISHMENT). USING THE OTHER METHOD, THE TRADE-THROUGH INCIDENCE WAS OVERSTATED TO BE 7.9% OF NASDAQ SHARE VOLUME. THIS LATTER NUMBER BEARS NO RELATION TO THE FACTS ON THE GROUND. EVEN IF 1.7% WERE AN ACCURATE READING, THAT NUMBER HARDLY WOULD JUSTIFY THE ECONOMIC DISLOCATION AND REDUCTION IN INVESTOR CHOICE THAT WOULD BE NEEDED TO ADDRESS THIS RELATIVELY SMALL PROBLEM.

**OTC DEVELOPMENTS.** IN THE YEAR SINCE THE OEA TRADE THROUGH STUDY WAS UNDERTAKEN AND CONCLUDED, NASDAQ PURCHASED BRUT ECN IN 2004, PROVIDING NASDAQ WITH SMART ORDER-ROUTING CAPABILITIES. ONCE THE INTEGRATION OF THE TWO SYSTEMS IS COMPLETE, TRADE THROUGHES ON THE NASDAQ MARKET SHOULD BE REDUCED, WITHOUT THE IMPOSITION OF ADDITIONAL REGULATION.

DURING THE STUDY DATES, THE ARCHIPELAGO EXCHANGE (“ARCAEX”) PLATFORM OPERATED AN EXTERNAL ORDER ROUTER THAT PERMITTED ORDERS IN THE ARCAEX PLATFORM TO REACH BETTER-PRICED LIQUIDITY OUTSIDE OF ARCA. EXTERNALIZING ORDERS MATERIALLY DECREASES THE OCCURRENCE OF TRADE THROUGHES, AS

EVIDENCED IN THE OEA TRADE-THROUGH STUDY. THOSE FINDINGS SUPPORT THE CONCLUSION THAT MARKETS USING SMART ORDER-ROUTING TECHNOLOGY CAN EFFECTIVELY REDUCE AND LIMIT TRADE THROUGHES FOR BOTH LARGE AND SMALL TRADES.

AS A RESULT OF THESE FLAWS, THE OEA TRADE-THROUGH STUDY IS AN INADEQUATE BASIS FOR REGULATORY ACTION. THE STUDY HAS BEEN INTRODUCED INTO THE TRADE-THROUGH DISCUSSION IN SUPPORT OF EXTENDING A TRADE-THROUGH RULE TO THE OTC MARKET. THE STUDY DOES NOT, HOWEVER, SUPPORT THE CONCLUSION THAT A TRADE-THROUGH RULE IS NECESSARY OR APPROPRIATE FOR THE OTC MARKET.

## **VII. THE SEC'S TWO TRADE-THROUGH PROPOSALS**

WE DO NOT SUPPORT EITHER OF THE TRADE-THROUGH PROPOSALS BECAUSE WE THINK A TRADE-THROUGH RULE IS BOTH UNNECESSARY AND BURDENSOME.

AS BETWEEN THE TOP-OF-BOOK ALTERNATIVE AND THE DEPTH-OF-BOOK ALTERNATIVE, WE THINK THE PHILOSOPHY OF A TRADE-THROUGH RULE IS MORE SUPPORTIVE OF THE LATTER BECAUSE THE UNIVERSE OF PROTECTED ORDERS WOULD BE EXPANDED TO INCLUDE NOT JUST THOSE AT THE TOP PENNY ON THE BID OR BOTTOM PENNY ON THE OFFER BUT ALL DISPLAYED ORDERS. THE LIMITED TOP-OF-BOOK ALTERNATIVE INVITES "PENNYING" AND PROVIDES VERY LITTLE NEW OR

MEANINGFUL PROTECTION IN A DECIMAL WORLD, WHILE LEAVING THE NYSE FREEDOM TO DISADVANTAGE INVESTORS AND FIDUCIARIES AND TO SHUT OUT ITS COMPETITORS.

THE DEPTH-OF-BOOK PROPOSAL DOES NOT HAVE THOSE DEFECTS, BUT WE THINK IT WOULD BE MORE THAN IS NEEDED TO ACCOMPLISH THE COMMISSION'S OBJECTIVE — AND WOULD BE LIKELY TO STIFLE INNOVATION AND COMPETITION.

#### **VIII. THERE IS AN ALTERNATIVE TO A TRADE-THROUGH RULE**

DECIMALIZATION HAS BEEN A BOON TO INVESTORS AND AN ENORMOUS SPUR TO MARKET EFFICIENCY. THIS COMMITTEE PLAYED A CRITICAL ROLE IN PRODUCING THIS MARKET REVOLUTION. HOWEVER, THE RULES GOVERNING THE DISPLAY OF MARKET DATA — RULES CRAFTED IN AN ERA OF EIGHTHS AND SIXTEENTHS — HAVE NEVER BEEN UPDATED TO REFLECT DECIMALIZATION.

SINCE DECIMALIZATION INTRODUCED 100 PRICE POINTS TO THE DOLLAR IN PLACE OF THE PREVIOUS EIGHT OR SIXTEEN, THE AMOUNT OF LIQUIDITY AVAILABLE AT THE NATIONAL BEST BID AND OFFER IS MUCH SMALLER THAN BEFORE. AS A RESULT, THERE HAS BEEN A DRAMATIC DIMINUTION IN TRANSPARENCY AND LIQUIDITY AT THE INSIDE QUOTATIONS.

THE SIA, IN COMMENTING ON REG NMS, ACCURATELY OBSERVED: “THE VALUE OF THE NBBO — THE CORNERSTONE OF THE MARKET DATA SYSTEM — IS LESS THAN IT WAS PRIOR TO DECIMALIZATION. WE BELIEVE THAT THE SEC HAS A RESPONSIBILITY TO ADDRESS THIS ISSUE IN LIGHT OF THE OPERATION OF ITS QUOTE AND DISPLAY RULES (RULES 11Ac1-1 AND 11Ac1-4 UNDER THE EXCHANGE ACT)....”<sup>2</sup>.

WE PUBLISH DATA ON EQUITY SECURITIES MARKETS THROUGHOUT THE WORLD. EVERY SIGNIFICANT MARKET OTHER THAN THE NYSE AND MEXICO CURRENTLY PUBLISHES REAL-TIME QUOTATIONS AT A MINIMUM OF FIVE LEVELS DEEP FOR ALL INVESTORS TO SEE AND IMMEDIATELY ACCESS ELECTRONICALLY. AS THE LARGEST EQUITY MARKET IN THE WORLD, THE NYSE SHOULD NOT CONTINUE TO DENY INVESTORS AND FIDUCIARIES THE SAME TRANSPARENCY AND ACCESS.

RATHER THAN INTRODUCE A NEW TRADE-THROUGH RULE, THE COMMISSION’S OBJECTIVES OF GREATER TRANSPARENCY AND ACCESS AND LIQUIDITY COULD BE BETTER ACHIEVED IF THE COMMISSION DID THE FOLLOWING:

- ELIMINATE THE EXISTING INTERMARKET TRADING SYSTEM TRADE-THROUGH RULE.

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<sup>2</sup> Securities Industry Association, Comment letter on Regulation NMS (February 1, 2005) at p. 24, in SEC File No. S7-10-04.

- REVIEW AND IMPLEMENT, WITH APPROPRIATE MODIFICATIONS, THE NYSE'S OPEN BOOK AND HYBRID MARKET PROPOSALS.
- AMEND THE LIMIT ORDER DISPLAY RULE, EXCHANGE ACT RULE 11Ac1-4, TO REQUIRE EXCHANGES, MARKET MAKERS AND OTHER MARKET CENTERS (INCLUDING ECNS) TO PUBLISH ANY CUSTOMER LIMIT ORDERS RECEIVED OR COMMUNICATED TO OTHERS WITHIN FIVE CENTS OF THEIR BEST PUBLISHED QUOTATIONS (THAT IS TO SAY, FIVE CENTS ABOVE THE BEST OFFER AND FIVE CENTS BELOW THE BEST BID).
- REQUIRE ALL MARKET CENTERS TO HAVE THEIR PUBLISHED QUOTATIONS — NOT JUST THE TOP OF FILE — BE FIRM AND IMMEDIATELY “TOUCHABLE” ELECTRONICALLY BY MEMBERS OR PARTICIPANTS AND, THROUGH SYSTEMS SUCH AS THE NYSE'S DIRECT+, BY NONMEMBERS ELECTRONICALLY ENABLED BY MEMBERS.

- EXTEND TO DEPTH-OF-MARKET QUOTATIONS THE COMMISSION'S 30-CENT PER 100 SHARES CAP ON ACCESS FEES.
- AMEND THE VENDOR DISPLAY RULE, EXCHANGE ACT 11Ac1-2, TO REQUIRE VENDORS, SUCH AS BLOOMBERG L.P., TO CARRY ON THE SAME TERMS AS TOP-OF-FILE QUOTATIONS ALL DEPTH-OF-BOOK QUOTATIONS PUBLISHED BY ANY MARKET CENTER AS THAT TERM WOULD BE DEFINED IN RULE 600 OF PROPOSED REGULATION NMS, WITH THE POSSIBLE EXCEPTION OF MARKET CENTERS WHOSE SHARE OF VOLUME IS INSIGNIFICANT.
- ENFORCE MEANINGFUL COMPLIANCE WITH FIDUCIARY STANDARDS BY BROKERS AND INVESTMENT MANAGERS SO THAT THEY USE REASONABLE MEANS TO SEEK BEST EXECUTION OF CLIENT ORDERS, INCLUDING GETTING THE BEST ALL-IN PRICES. IF INVESTMENT MANAGERS AND BROKERS TODAY HAVE BEEN LAX IN LIVING UP TO THEIR DUTIES, THEY SHOULD BE REMINDED OF THEIR DUTY TO SEEK BEST EXECUTION OF ALL ORDERS. AUDITING OF THIS

DUTY — POSSIBLY COUPLED WITH ENHANCED DISCLOSURE SUCH AS THE COMMISSION IMPOSED ON MARKET CENTERS IN EXCHANGE ACT RULE 11Ac1-5 AND BROKERS IN RULE 11Ac1-6 — WOULD REDUCE INAPPROPRIATE TRADE THROUGHS AND MAKE A TRADE-THROUGH RULE UNNECESSARY.

WE THINK THE COURSE OF ACTION WE RECOMMEND WOULD PROMOTE A NUMBER OF BENEFICIAL EFFECTS. THERE WOULD BE A GREATER INCENTIVE THAN THERE IS TODAY TO PLACE LIMIT ORDERS. TODAY, FOR EXAMPLE, A MARKET PROFESSIONAL CAN OBSCURE A LARGE ORDER AT THE NBBO BY JUMPING AHEAD OF IT FOR A PENNY. AS A RESULT, THE ORIGINAL LIMIT ORDER IS NO LONGER VISIBLE OR ACCESSIBLE. (THE SAME PERVERSE INCENTIVE EXISTS UNDER THE “TOP OF FILE PROPOSAL.”) IN EFFECT, INVESTORS ARE PENALIZED FOR QUOTING AGGRESSIVELY. WITH THE APPROACH WE RECOMMEND, PENNYING AN ORDER WOULD NOT BLOCK DISCLOSURE OF OR ACCESS TO THE ORIGINAL LIMIT ORDER.

THE COMBINATION OF MANDATORY TRANSPARENCY AND FAIR ACCESS TO QUOTATIONS BEYOND THE TOP OF FILE WOULD BENEFIT ALL INVESTORS, FIDUCIARIES AND OTHER MARKET PARTICIPANTS AND MAKE FOR A MORE TRANSPARENT AND LIQUID NATIONAL MARKET SYSTEM.

BROKERS AND INSTITUTIONAL INVESTORS WOULD HAVE TO BE ABLE TO REACH ALL SOURCES OF PUBLISHED LIQUIDITY TO MEET THEIR BEST-EXECUTION OBLIGATIONS. THE BEST-EXECUTION DUTY TODAY RESIDES WITH INVESTMENT MANAGERS AND BROKERS; THIS IS WHERE IT SHOULD BE, NOT WITH MARKET CENTERS. EXCHANGES AND MARKET CENTERS SHOULD NOT BE REQUIRED TO ESTABLISH ROUTING FACILITIES TO OTHER MARKETS. ALREADY EXISTING WIRE CONNECTIONS AND SMART ROUTERS SHOULD PROVIDE COST-EFFECTIVE MEANS OF DIRECTING ORDER FLOW TO THE MARKETS OFFERING THE DEEPEST LIQUIDITY AT THE BEST PRICES.

THIS IS A MODEST PROPOSAL. THE IMPACT OF THESE STEPS WOULD BE TO RESTORE THE TRANSPARENCY THAT HAS BEEN LOST AS AN UNINTENDED AND UNFORESEEN RESULT OF DECIMALIZATION. AS A POLICY MATTER IT IS HARD TO ARGUE THAT DECIMALIZATION SHOULD LEAVE THE PUBLIC WITH *LESS* TRANSPARENCY.

THE IMPACT OF SIMPLY UPDATING THE DISPLAY RULES, HOWEVER, COULD BE PROFOUNDLY POSITIVE IN ENCOURAGING THE DISPLAY OF DEPTH OF BOOK IN A FASHION THAT RELIES ON MARKET FORCES INSTEAD OF GOVERNMENTAL REGULATION. THIS IS FAR LESS INTRUSIVE THAN A TRADE-THROUGH RULE, WHICH WOULD BE EXPENSIVE TO IMPLEMENT AND DIFFICULT TO MONITOR AND ENFORCE.

ARMED WITH BETTER TRANSPARENCY AND ACCESS TO MARKET QUOTATIONS, BROKERS AND INVESTMENT MANAGERS WOULD HAVE POWERFUL INCENTIVES — PARTICULARLY GIVEN THEIR “BEST EXECUTION” DUTIES — TO REACH OUT FOR THE BEST PRICES AVAILABLE IN ANY MARKET, WHICH WOULD INCREASE INTER-MARKET COMPETITION AND LOWER TRANSACTION COSTS.

**IX. THE MARKET BBO ALTERNATIVE AND  
THE NYSE HYBRID MARKET PROPOSAL**

IF THE COMMISSION OPTS FOR THE MARKET BBO ALTERNATIVE, THERE ARE SIGNIFICANT RISKS REGARDING HOW THAT ALTERNATIVE WOULD INTERACT WITH THE NYSE HYBRID MARKET PROPOSAL. AS WE AND OTHER COMMENTERS HAVE PREVIOUSLY NOTED, SEVERAL ASPECTS OF THAT PROPOSAL ARE ILLOGICAL AND CUT AGAINST THE COMMISSION’S GOALS OF TRANSPARENCY AND FAIRNESS. MOST NOTABLY, THE “CLEAN UP” PRICE UNFAIRLY PENALIZES INCOMING MARKET AND MARKETABLE LIMIT ORDERS BY CHOOSING ARBITRARILY TO GIVE LIMIT ORDERS A BETTER DEAL THAN THEY HAD BARGAINED FOR IN SETTING THEIR LIMIT PRICES.

IF ALL ORDER GIVERS WERE BEING TREATED EQUALLY, THAT REGULATORY SUBSIDY FOR LIMIT ORDERS MIGHT BE DEFENSIBLE ON THE THEORY THAT INVESTORS SHOULD BE FAIRLY REWARDED FOR STEPPING UP AND GIVING THE MARKET WHAT IS IN ESSENCE A FREE OPTION.

NONETHELESS, THE NYSE HAS THUS FAR CHOSEN TO GIVE ITS FLOOR MEMBERS AN ADDITIONAL AND UNFAIR SUBSIDY IN THE FORM OF THE BROKER AGENCY INTEREST FILE AND THE SPECIALIST INTEREST FILE. THOSE NEW CONTRIVANCES WOULD GIVE FLOOR BROKERS A SPECIAL ADVANTAGE IN PLACING SECRET ORDERS INTO THE MARKET IN COMPETITION WITH DISCLOSED ORDERS. THAT, IN OUR VIEW, SUBSTANTIALLY DIMINISHES, IF INDEED IT DOES NOT VITIATE, WHATEVER POSITIVE ADVANTAGES MIGHT BE THOUGHT TO HAVE ARISEN FROM GIVING LIMIT ORDERS THE CLEAN-UP PRICE SUBSIDY.

THE BROADER ISSUE OF COURSE IS THE INTERACTION OF ALL THE PIECES OF THE MARKET STRUCTURE PUZZLE — REG NMS, OPEN BOOK, AND THE NYSE HYBRID PROPOSAL. AS REG NMS ENVISIONS MARKET PARTICIPANTS BEING REQUIRED TO GO TO THE NYSE, THERE IS A STRONG ARGUMENT THAT THESE OTHER NYSE PROPOSALS BE ADDRESSED FIRST, SO THAT MARKET PARTICIPANTS HAVE A CLEARER VISION OF HOW THE NYSE WILL FUNCTION. MOVING INITIALLY ON OPEN BOOK AND THE HYBRID WOULD ALSO ALLOW THE COMMISSION TO MEASURE THE IMPACT OF THESE INITIATIVES AND THEN DETERMINE WHETHER IMPLEMENTATION OF A FULL-DEPTH OF BOOK TRADE-THROUGH IS NECESSARY.

WE THINK THE NYSE IN FACT HAS MADE ENCOURAGING PROGRESS — UNDER THE CONSTANT AND EFFECTIVE PRODDING OF THE SEC. ITS OPEN BOOK PROPOSAL HAS SOME SHORTCOMINGS, BUT IF

IMPLEMENTED PROPERLY IT COULD RESTORE THE TRANSPARENCY THAT WAS LOST TO DECIMALIZATION. THE HYBRID MARKET PROPOSAL, IN ITS DIRECT+ ELEMENT, OFFERS ENHANCED ELECTRONIC ACCESS TO THE PUBLISHED QUOTATIONS. BOTH OF THOSE DEVELOPMENTS REPRESENT A WELCOME MODERNIZATION OF THE MARKET. WE THINK THE COMMISSION SHOULD PAUSE TO LET THEM BE PROPERLY IMPLEMENTED<sup>3</sup> BEFORE GIVING FURTHER CONSIDERATION TO WHETHER A TRADE-THROUGH RULE IS NECESSARY OR DESIRABLE.

WE EXPECT THAT, WITH INCREASED DISCLOSURE OF MARKET DATA, FIDUCIARIES AND INVESTMENT INTERMEDIARIES COULD NOT AND WOULD NOT IGNORE THOSE QUOTATIONS WHEN MAKING ORDER-ROUTING DECISIONS. ADHERENCE TO FIDUCIARY AND AGENCY DUTIES WOULD, WE BELIEVE, PROVIDE APPROPRIATE DISCIPLINE AND MAKE A TRADE-THROUGH RULE UNNECESSARY.

#### **X. REG NMS AND MARKET DATA**

THE CHAIRMAN OF THIS COMMITTEE HAS OFTEN OBSERVED THAT MARKET DATA IS THE “OXYGEN” OF THE MARKETS. ENSURING

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<sup>3</sup> The Commission appropriately blocked the NYSE’s efforts to impose via contracts with market vendors improper limits on Liquidity Quote, which is substantially similar in operation to Open Book. These improper limits would have diminished the opportunity for competing market centers to offer comparable transparency. *Matter of Bloomberg*, Securities Exchange Act Release No. 49076 (January 14, 2004), avail. at: <http://www.sec.gov/litigation/opinions/34-49076.htm>. The NYSE has refiled its Liquidity Quote proposal with the Commission. There still are imperfections and shortcomings in that proposal, and in Open Book, and they are still under review at the Commission.

THAT MARKET DATA IS AVAILABLE IN A FASHION WHERE IT IS BOTH AFFORDABLE TO RETAIL INVESTORS AND WHERE MARKET PARTICIPANTS HAVE THE WIDEST POSSIBLE LATITUDE TO ADD VALUE TO THAT DATA ARE HIGH PRIORITIES.

IN ITS 1999 CONCEPT RELEASE ON MARKET DATA, THE COMMISSION NOTED THAT MARKET DATA SHOULD BE FOR THE BENEFIT OF THE INVESTING PUBLIC. INDEED, MARKET DATA ORIGINATES WITH SPECIALISTS, MARKET MAKERS, BROKER-DEALERS AND INVESTORS. THE EXCHANGES AND THE NASDAQ MARKETPLACE ARE NOT THE SOURCES OF MARKET DATA, BUT RATHER THE FACILITIES THROUGH WHICH MARKET DATA ARE COLLECTED AND DISSEMINATED. IN THAT 1999 RELEASE, THE SEC PROPOSED A COST-BASED LIMIT TO MARKET DATA REVENUES.

THAT COST-BASED APPROACH WOULD NOT REQUIRE THE NYSE AND NASDAQ TO SELL THE DATA AT COST. INSTEAD, IT WOULD REQUIRE THE CHARGES TO BE REASONABLY RELATED TO THE COST OF COLLECTING AND DISSEMINATING THE DATA. TODAY, THE SRO NETWORKS SPEND ABOUT \$40 MILLION ON COLLECTION AND DISSEMINATION AND RECEIVE OVER TEN TIMES THAT MUCH — \$424 MILLION — IN REVENUES.<sup>4</sup> THOSE REVENUES COME FROM INVESTORS.

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<sup>4</sup> See, Regulation NMS, Securities Exchange Act Release No. 50870 (December 16, 2004) in text accompanying n. 286:

FOR MONOPOLISTS SUCH AS THE NYSE AND NASDAQ TO CONTINUE TO RIDE ON THAT GRAVY TRAIN IS SIMPLY WRONG.

WE BELIEVE THE SEC WAS CLOSER TO THE MARK IN 1999 WHEN IT PROPOSED MAKING MARKET DATA REVENUES COST-BASED, THAN IN ITS REGULATION NMS PROPOSAL, WHICH SETS FORTH A NEW FORMULA FOR DISPENSING MARKET DATA REVENUE WITHOUT ADDRESSING THE UNDERLYING QUESTION OF HOW TO EFFECTIVELY REGULATE THIS MONOPOLY FUNCTION.

THE SEC WILL BE REVIEWING MARKET DATA FEES AS PART OF THE SRO STRUCTURE CONCEPT RELEASE. WE URGE THE SEC TO MOVE EXPEDITIOUSLY TO ADDRESS THIS IMPORTANT ISSUE, AND WE EMBRACE THE SIA'S CALL FOR A COST-BASED APPROACH TO MARKET DATA FEES. EVERY INVESTOR WHO BUYS AND SELLS STOCKS HAS A LEGITIMATE CLAIM TO THE OWNERSHIP OF THE DATA AND LIQUIDITY HE OR SHE PROVIDES TO MARKET CENTERS. FUNNELING EXCLUSIVE LIQUIDITY INFORMATION TO EXCHANGE MEMBERS AND FUNNELING MARKET DATA REVENUES TO EXCHANGES AND NASDAQ AND NOT TO INVESTORS SHIFTS THE REWARDS FROM THOSE WHO TRADE TO THOSE WHO FACILITATE TRADING. THE BENEFITS OUGHT TO BE CONFERRED UPON THE PUBLIC.

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In 2003, the Networks collected \$424 million in revenues derived from market data fees and, after deduction of Network expenses, distribute \$386 million to their individual SRO participants. [footnote omitted].

## **XI. ACCESS FEES SHOULD BE ABOLISHED**

ACCESS FEES — WHICH THE COMMISSION ALLOWED ECNS TO CHARGE WHEN IT ADOPTED THE ORDER EXECUTION RULES — ARE DYSFUNCTIONAL AND SHOULD BE ENTIRELY ABOLISHED. WE APPLAUD THE COMMISSION’S DECISION TO ABANDON THE CONVOLUTED APPROACH SUGGESTED WHEN REGULATION NMS WAS FIRST PROPOSED, BUT WE DO NOT THINK THE COMMISSION HAS GONE FAR ENOUGH. THE COMMISSION SHOULD NOT PRESERVE ACCESS FEES. THEY HAVE BEEN A CONTINUAL SOURCE OF MISCHIEF, SUCH AS REBATING PRACTICES, AND MARKET DISRUPTION, SUCH AS LOCKS AND CROSSES. IN ADDITION, THEY PROMOTE INTERNALIZATION OF ORDERS, WHICH REMOVES LIQUIDITY FROM THE NATIONAL MARKET SYSTEM. THERE IS NO GOOD ARGUMENT FOR KEEPING THESE FEES. THE COMMISSION’S DECISION TO RETAIN THEM IS, IN OUR VIEW, A SUBSTANTIAL MISTAKE.

## **CONCLUSION**

THIS COMMITTEE HAS BEEN IN THE FOREFRONT OF THE MARKET STRUCTURE DEBATE AND I APPRECIATE THE OPPORTUNITY TO DISCUSS HOW THESE SEEMINGLY ABSTRACT ISSUES HAVE A CONCRETE REAL-WORLD IMPACT ON INVESTORS.

REGULATION NMS IS A BOLD STEP TO BRING OUR MARKETS INTO THE 21<sup>ST</sup> CENTURY. THE SEC IS TO BE COMMENDED FOR PROMPTING

WHAT HAS ALREADY BEEN A PRODUCTIVE DEBATE. IN AN EFFORT TO ACCOMMODATE A DIVERSE ARRAY OF INTERESTS, HOWEVER, WE BELIEVE THERE IS A RISK THAT REGULATION NMS MAY RE-SHUFFLE, RATHER THAN ELIMINATE, CURRENT IMPEDIMENTS TO MARKET EFFICIENCY.

ELIMINATION OF THE TRADE-THROUGH RULE, ELIMINATION OF ACCESS FEES, AND GREATER EFFORTS TO ENHANCE THE TRANSPARENCY AND CONTROL THE COSTS OF MARKET DATA WOULD HELP PROMOTE A 21<sup>ST</sup> CENTURY EQUITY MARKET THAT BEST SERVES INVESTORS.

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