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Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth St., NE
Washington, DC 20459-000609

RE: [Release No. 34-49325; File No. S7-10-04]

Dear Mr. Katz:

I am writing in response to your release titled Regulation NMS. As many on the Commission's staff know, I have a long-standing interest in market structure, in particular the "Listed" equity market. This interest began about 1960 when the impact of the Third Market first became public through the SEC's Special Study on Securities Markets. At the time, Weeden & Co. (legally unrelated to the present Weeden) was the largest Third Market dealer and I represented them on various committees and at hearings before Congress and the SEC. I was also privileged to serve on the National Market Advisory Board created by the Exchange Act Amendments of 1975 and whose role was to offer guidance to the Commission on creating a National Market System (NMS) that would best meet the objectives outlined in that Act.

With this background, I would like to offer some comments on your NMS release and some suggestions for your consideration..

A few preliminaries if I may. First you should understand that these comments and suggestions represent my personal views and not that of Weeden & Co. That is not to say my partners disagree with me, but as active participants in the day-to-day business of the market, they would prefer that I have full freedom to say what I think is in the best interest of the public.

Second, I commend the Commission's staff on the detail and careful analysis contained in their lengthy report. The release contains a number of interesting and creative solutions for some rather complex problems.

Third, I also commend the staff, and the Commission, for their willingness to keep an open mind on these matters and to consider suggestions from others.

Now to the proposals themselves.

<u>Sub Decimal Pricing</u>

I agree that sub decimal pricing should not be allowed in any market display, with the exceptions noted. Sub decimal pricing provides minimal benefits to the public investor and could be misused to undermine the markets ability to attract limit orders, something your release repeatedly stresses as important.

<u>Market Access Proposal</u>

This is primarily an effort to reduce the problem of locked markets and crossed markets occurring in the over the counter market and does not apply to the listed market where the Intermarket Trading System (ITS) provides a <u>no fee</u> communications/execution link among all market centers. Providing a <u>no fee</u> ITS for over the counter securities would solve this problem and would avoid a spread of access fees – even though limited – where they presently don't exist. Incidentally, the NASDAQ system is the logical facility to provide <u>no fee</u> linkages if it could be reestablished as a neutral entity servicing all market centers and market providers equally. To the extent that is not possible, your suggestion to restrict the size of fees seems reasonable.

With respect to the listed market, the ITS <u>no fee</u> structure should be maintained.

<u>Market Data Proposal</u>

I find it commendable that the Commission seeks to reformulate the revenue distribution of market data to give greater incentives to those providing liquidity in the market place.

I also find it commendable that the Commission is considering changes in the governing structure of the Consolidated Tape Association in order to accomplish this.

Having said that, I believe your proposals fall far short of what is necessary. Market data revenue is the one area in which changes since 1975 call for a fundamental review of the level deemed appropriate, who should receive them, and how the process should be governed.

I was a member of all the committees that first designed the Consolidated Tape and Composite Quote System, and take some responsibility for the present structure.

At the time revenues and costs had a reasonable relationship to one another and the distribution formula was designed to give a slight advantage to the regionals who did not have listing fees to offset their expenses. It worked well and is reputed to have even maintained the solvency of some of the regionals for many years. But with the enormous increase in reported volume, tape and quote revenues have become a boondoggle of egregious proportion which should no longer be countenanced.

If one agrees that the data being collected is in fact the public's data (the CTA disagrees) the net revenues should be passed onto them either in the form of lower distribution charges or indirectly by strengthening market liquidity.

At a time when the broker dealer community is grappling with penny spreads and pressure on commissions rates from its clients, the fact that the CTA collects revenues of $424 million and distributes $384 million of it to its Board members can not be tolerated.

As it presently stands the CTA's Governing Board, made up of the various market centers, with veto power in the hands of any one participant, has little ability and no desire to reduce costs or revenues. The situation reminds me of the days before negotiated commissions when the industry maintained a fixed minimum commission with the Commission's approval. This market center oligopoly must go.

I suggest restructuring the Consolidated Tape Association (CTA) board to include a majority from the public with a mandate and power to do what is in the best interests of the investor. Depository Trust and Clearing Corp. (DTCC), is the right model – and with some encouragement might even be induced to be the administrator.

<u>The Trade-Through Rule Proposals</u>

Before tampering with the Trade-Through Rule the Commission should fix the Intermarket Trading System (ITS). The myriad rule changes contemplated in your release, the complicated exceptions, compliance issues extending to customers on a trade by trade basis will prove a nightmare of additional costs and complexity to an already over burdened industry and with questionable value to the public investor. Its implementation is the straw that would cause this liberal spirit to turn libertarian.

ITS Key to the NMS

When I suggest "fixing" the ITS, I mean requiring the quotes submitted from the various market centers to be firm and available for real time execution. And then require any trade at a price inferior to the posted Best Bid and Offer (BBO) to clear the ITS book. There would be no responsibility by any market center to look beyond the ITS.

You can then get rid of the Trade-Through Rule altogether and rely on the Best Execution Rule to protect the public's interest. Also you can let the professional investor trade at whatever price he wants, relying on his fiduciary responsibilities to do the right thing.

Presto! You're one step away from the National Market System envisioned in the Exchange Act Amendments of 1975.

The only thing missing is time priority for public limit orders but you've at least structured the market to easily accommodate that when and if.

To meet the complaints of the institutional investors the Commission should also consider expanding the scope of the ITS to include several levels of bid and ask prices. We know that existing technology is capable of doing this but the cost is uncertain. The Commission might want to solicit indications from suppliers in order to assess costs vs benefits.

Fixing the ITS is a simple, straight forward and doable solution available to the Commission under Section 11A (proposed section 609) of the Act. Beyond being simple, it solves a lot of problems and offers many improvements to the market.

- It encourages the use of limit orders
- It creates a level playing field for all participating market centers by centralizing and neutralizing the limit order book.
- It gets rid of access fees
- It eliminates the fast market/slow market problem.
- It eliminates the Trade-Through issue
- It simplifies obtaining best execution
- It simplifies the data distribution process

- It enhances the ability of individual markets to attract order flow.
- It greatly improves the competitive environment among the market centers and market providers.
- And if one gave priority to posted bids it would further encourage market making.

I would like to point out that it is not a new idea. The first time I heard it well articulated was in the 1972 hearings before Congressman Moss' committee on the securities industry.

The speaker was the late Frank Graham who, at the time, had his own specialist firm and was Chairman of the American Stock Exchange. We were on the same panel. It was just after the NASDAQ system began operations and everyone had become excited about its prospects.

Frank in reply to a question, I believe from Congressman Eckhardt, said the following:

> *"I will give you a for instance as to how I view this thing (central marketplace). Today, and in the very near future, we and others, who will have the capability, can get an input device into a central computer, which would give the Midwest Stock Exchange the ability not only to enter dealer interests in the stock, in the absence of public interest, but to enter public orders from the Midwest that would be stored in this central computer.*
>
> *I can envision a market being 68½, if you will, where the first bid into the system might be a 68 bid out of New York, the second bid might be a 68 out of the Pacific and a third bid might be a 68 bid for a couple of hundred shares from the Midwest exchange, all to the central system.*
>
> *Then the way this would operate, in effect, wherever an order came in to activate this bid, the bid would be taken in the order it was recorded in the system.*
>
> *The public would be protected in all markets, and through the markets you would provide the various access of other members and dealers in those markets to trade across and through the markets on an equitable basis."*

Here in 2004, 32 years later, we are not yet there. But we could be if the Commission does what it has outlined so concisely as the purpose of these new regulations; namely:

> *"To do what is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets, and the removal of impediments to, and perfection of the mechanisms of a National Market System."*

Therefore, I recommend the Commission use its authority under the Exchange Act Amendments to direct the CTA/ITS Association to change its rules to implement an ITS that provides firm quotes and real time execution.

I would appreciate the opportunity to appear before the Commission to elaborate on my suggestions and answer questions.

Sincerely,

Donald E. Weeden