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Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street N.W.
Washington, D.C. 20549-0609

Re: File No. S7-10-04;
Proposed Regulation NMS

Dear Mr. Katz:

I am an active teacher and researcher in the area of market microstructure. Therefore, I feel I am qualified to opine on the proposed market regulation changes. Earlier this week, I sent you a request to testify before the commission on April 26 on the above topic. Below is a summary of my intended testimony.

With regard to the proposed changes to the **trade though rule,** I fully support the position that price priority should established in all markets. I also agree that traders should be allowed to make an informed decision to opt-out on a trade by trade basis. A trade by trade affirmative opt-out is much more desirable than a blanket client opt-out, since the latter is subject to abuse by brokers. Finally, I agree that a trade by trade opt-out negates the need to have a general exception to the rule for block trades.

With regard to the **proposed ban on sub-penny quoting**, I was one of a number of academics that testified before Congress in support of decimalization. I wish to point out that decimalization does not mean penny ticks – it means quoting in dollars and cents. For example, the Toronto Stock Exchange “decimalized” and adopted nickel ticks for stocks trading above C$5. As studies have shown a small tick encourages stepping-ahead and thus discourages traders from placing limit orders. These traders do not necessarily exit the market. They merely switch to using market orders and monitor the market more closely – sending in additional liquidity as conditions become favorable.

Limit orders are shock absorbers for liquidity events. Without limit orders to absorb trades from liquidity demanders, large orders will increasingly walk the book. While it may be argued that price impact is a fact of life for institutions, I am more concerned about the small trader that submits an order in the same direction, but just behind the large order. The small order will execute at an inferior price before sufficient liquidity can be sent to the market by traders.

While it is true that a lower tick will reduce spreads on *some* stocks, this improvement in spread must be balanced against other market quality measures such as depth. In the example I just gave, the small trader does not necessarily benefit from a narrower quoted spread because increased price volatility may cause an increase in effective spreads. Therefore, I am in favor of a significant tick which balances spread width improvement against liquidity provision. Banning sub-penny quoting will encourage placement of limit orders since it makes stepping ahead more costly. In fact I urge the commission to think about raising the minimum tick size for non-penny stocks to a nickel from the current penny.

I am pleased to see that the Commission is joining the growing awareness among exchanges and regulators around the world, that enacting rules that encourage limit order submission is equally important to reducing transaction costs.

With regard to the **market data fees proposal**, I believe that the Commission should keep the current consolidated model. Investors may otherwise not be aware of better prices that exist merely because their source of data does not subscribe to a particular feed. Investors need uniformity.

I applaud the Commission for the ingenious proposal to link price discovery contribution to fee allocation. The Commission has realized that market participants will change their behavior to maximize their own income stream. For example when the current trade based scheme was introduced, NYSE specialists were in the habit of bunching trades together near the open to reduce their workload. When specialists realized that they were paid per print, they un-bunched the trades to increase data revenues.

The current allocation scheme was enacted at a time when regional stock exchanges were experiencing a decline in listings and the associated fees. It is my understanding that the current plan was designed in part to keep the regional exchanges afloat. The Commission no longer needs to do this, since the regionals have developed models to attract order flow that keeps them afloat, or have diversified into other products.

The current system does indeed provide incentives to SROs to attract prints. The

Chicago Stock Exchange started this a number of years ago in Amex stocks when Amex stocks had relatively large per-print revenue. The proposal will use data fees to encourage SROs to quote, not just free ride off another SRO's quotes. It goes a step further by awarding a higher allocation to an SRO that improves on existing quotes. Therefore, the proposed allocation scheme will encourage price competition.

Over the years NASDAQ spreads have been generally wider than NYSE spreads. Many academics attribute this disparity to the widespread occurrence of preferencing schemes whereby dealer firms compete for a broker's business and not for natural buyers and sellers of a security. Tue competition should be between natural buyers and sellers. This proposed allocation scheme will tip the scales clearly in favor of public customers. The result should be an improvement in market quality. `

Sincerely;

Daniel G. Weaver, Ph.D.
Associate Professor of Finance