U.S. Securities and Exchange Commission Hearing on Proposed Regulation NMS
New York Stock Exchange, Inc.
John A. Thain, Chief Executive Officer
Robert G. Britz, President and Chief Operating Officer
April 21, 2004

Introduction

Mr. Chairman, Members and Staff of the Commission, thank you for the opportunity to present our views on proposed Regulation NMS today. The proposal seeks to deal with a number of market structure issues in the securities market that have arisen since the creation of the National Market System almost 30 years ago. We applaud the Commission for taking a comprehensive approach on issues which may seem separate and distinct at first glance, but which are inextricably linked.

Markets will inevitably evolve over time, and as they do it is important to consider the interests of all market participants and the principles that are fundamental to keeping our markets the largest, most efficient and most liquid in the world. Since joining the NYSE, I have been speaking with many of our constituents and listening to their views. Not surprisingly, I have come to many of the same conclusions as the Commission about market structure. Our primary responsibility as an exchange is to serve and protect the interests of investors small and large, to provide listed companies with a venue in which to raise the capital they need to grow, and to provide a variety of execution choices to the trading community. In balancing the interests of these constituencies, there are principles we should pursue that are essential to good public policy and to keeping the markets efficient:

- Best Price – every order, regardless into which market it is entered, should compete with every other order and receive the best price, period.
- Liquidity –orders should be shown and given the opportunity to compete with other orders and protected on execution; internalization reduces displayed liquidity, harms the market by reducing the opportunity for greater order interaction, and creates conflicts between fiduciaries and their customers.
- Volatility –stable markets encourage investment—our listed companies and investors appreciate that the NYSE has significantly less intraday volatility than the OTC market.
- Speed – speed should be an option for those customers who want it;
- Price Discovery – markets exist to manufacture prices. For any given stock, any given quantity, at any given moment, those prices should be accurate and reflect the underlying fundamentals of the company.
- Choice – investors and markets are best served when offered a range of trading options, including anonymity.

- The Customer Comes First – market data rebates and other payment arrangements that provide incentives for intermediaries to look after their own interests ahead of those of their customers should be prohibited.

Proposed Regulation NMS is based on generally the same principles, and the Commission and Staff have thought carefully through the implications of most of the changes proposed. There are, however, several areas of inconsistency.

Trade-Through Rule

The trade-through rule was originally adopted to increase quote competition and ensure nation-wide price protection, which the Commission had termed a "critical" national market system goal. That objective is as crucial to our markets today as it was then. The trade-through rule plays a key role in protecting the investor, both large and small. The rule guarantees that investors in NYSE listed stocks will receive the best prices available regardless of the market to which orders are sent, and that investors who provide the best prices are protected. While we believe some of the changes that Regulation NMS proposes are warranted, others would be contrary to the interests of investors, listed companies, and the integrity of our public markets.

The trade-through rule is a cornerstone of our market system. When it is violated, there are four victims:

1) The investor who bought or sold shares at a price other than the best price;

2) The investor whose better-priced order is ignored;

3) National price discovery, since a stock is valued at something other than the true market price;

4) And finally, market liquidity, since investors will lose confidence in the fairness of the market and will be less willing to submit limit orders knowing they may be traded through.

Some of our constituents have told us that they can better serve their investors by taking a price available immediately over a price they may receive on the floor of the Exchange in 15-20 seconds. Where there are significant differences in speed between markets, I am sympathetic to that argument. Prices can change during that period, either to the investor's benefit or detriment. That is why we are moving quickly to leverage technology to offer a choice to our investors and all constituents of the Exchange.

This January, our Board of Directors approved a proposal to make the speed and execution certainty of our existing automatic execution platform—known as NYSE Direct +—available to a wider range of investor orders. We are in discussions with the SEC on this offering, and are continuing to work with Staff on its approval. Direct + will offer faster speed of execution for those clients who want it, foregoing price improvement that often occurs in the agency auction process. Trades that are executed using Direct+ would still be guaranteed the best price available within the national market system, whichever market may be displaying that price.

Some have argued that the trade-through rule is out-of-date because it does not take into consideration the need for speed. To the extent that speed affects one's ability to access the best price, it is an important factor. However, we do not believe that speed is an end in and of itself. Technology has advanced to the point where trades can be executed at lightning speed, but technology should not drive market structure decisions—principles should. The fundamental principle that the National Market System has been based on since its inception is best price—best price protection and best price accessibility. That is why we support retention of the trade-through rule.

The principle of best price is also critical for listed companies. NYSE-listed companies currently enjoy the advantages of head-to-head price competition where all buyers and sellers bid against one another in real time for shares. Companies find their share prices are less volatile and more reflective of fundamentals. The 39 companies which moved their listing from Nasdaq to NYSE during 2002 and the first quarter of 2003 found price volatility reduced by half. This reduced volatility helps attract investors, raise share prices, and reduce their cost of capital.

And finally, the trade-through rule is essential for the integrity of the markets. It ensures prices reflect the best outcome of supply and demand, which is essential for investors, regulators, and others relying on reported prices. It keeps the exchanges and ECN's linked and in open competition with one another. It enables the smallest investor to receive the same price as the largest institution. It enables the market price to reflect the true supply-demand balance for shares, ensuring stocks are properly valued even for those not participating in the trade.

Opt-Out

Concerning best price protection, proposed Regulation NMS acknowledges the value of protecting a displayed price from trades occurring at inferior prices in other markets, and notes that "price protection" encourages the display of priced orders and fosters the execution of customer orders. As a result, the proposal extends application of the trade-through rule to Nasdaq-listed stocks.

Given the Commission's emphasis on preserving and even extending best price protection we are surprised that Regulation NMS includes a provision allowing informed investors to "opt-out" of the trade-through rule. When speed and anonymity are on equal terms across markets, there is no reason and no justification to allow one to "opt-out" of the trade-through rule. Permitting this would have potentially grave consequences for our market and undermine the stated goals of Regulation NMS.

Adoption of the opt-out proposal would reverse many of the national market system benefits that proposed Regulation NMS recognizes accrue from the trade-through rule. When trades occur at prices worse than the displayed quote, it gives the impression of unfairness in the market system. Investors whose best-priced orders are ignored will perceive that the marketplace is treating them unfairly and withdraw those limit orders, thereby reducing liquidity, widening quotes and increasing execution costs for all investors. We believe that internalization away from the national best quote will increase if best price no longer matters; the national best quote will become the "best price" for retail orders. The national market system could be bifurcated into institutional and retail segments, impacting liquidity and the competitive position of U.S. securities markets. Retail investors will lose their opportunity to participate in size transactions that alter the equilibrium price.

The proposal limits the ability to opt out to those making an "informed decision to affirmatively opt out of the trade-through rule's protections." The proposal does not address how investors in mutual funds and others who had entrusted trading to fund fiduciaries would be able to indicate they did not want to give up those protections. We are concerned about the cost to ultimate investors of allowing traders to opt out of best price obligations of the trade-through rule. These costs could be substantial. In addition, the opt out does nothing to protect the better bid or offer which was traded through.

Market Data

We recognize that the Commission needs to address a number of objectionable practices that have arisen over the past decade, including the use of exchanges as print facilities, payment for order flow, wash sales and tape shredding. We agree that these are serious issues but we would prefer an approach that deals with them directly, rather than through market data revenue. For example, using markets as print facilities for transactions that occur elsewhere, thereby distorting perceptions of market liquidity and undermining price transparency, is a much bigger issue than the market data revenue split. The Commission should simply ban the undesirable practices because the national market system should provide brokers with incentives to do what is best for their customers.

A centerpiece of the Commission's solution is a new revenue-allocation formula that attempts to reward markets that contribute to price discovery. We applaud that principle. However, the proposed formula is extraordinarily complex, does not extinguish today's "print facility" mentality and raises questions vis-à-vis costs/benefits. In our experience, adding complexity increases the potential for "gaming" the formula. We believe that there may be simpler ways to achieve the desired objective, which we hope to explore with Commission staff.

The undesirable practices that Regulation NMS seeks to address are in large part a by-product of the markets' joint action under the market data plans. As we have publicly stated on a number of occasions, the benefits that originally derived from the markets' joint action under the plans no longer outweigh the costs. Maintaining the CTA consortium breeds dysfunction. It limits customer choice, raises antitrust issues, and gives rise to the need for complicated revenue-sharing formulas that will always be subject to exploitation.

The Commission's Advisory Committee on Market Information recommended that competition in data consolidation would improve the quality of data provided to investors. We agree. We also fully support Regulation NMS's proposals to allow markets more freedom to distribute their information free from mandatory consolidation, to allow vendors more alternatives to display information, and most importantly, to allow customers more choice in selecting the information they wish to obtain.

Market Access

We understand the SEC's desire to address the fact that ECN access fees distort the market, and liquidity provider rebates provide incentives for locking markets. We concur in principle with the Commission's prescription to the problem, a cap on access fees. We are concerned, however, about the lack of differentiation in the proposal between ECN access fees and exchange transaction fees, which are charged only to members. We plan to review this matter with the Commission in the coming weeks.

Sub-Penny Pricing

We support the Regulation NMS language on sub-penny pricing. The SEC has correctly noted that sub-penny quotes have tended to cause "stepping ahead" for insignificant amounts, and an increase in flickering quotes. These prices have had a distorting impact on the market without necessarily benefiting investors, and we would favor extending the policy on sub-pennies to ETF's.

Conclusion

Regulation NMS will determine the shape and form our capital markets will take for years to come and we look forward to working with the SEC in the weeks ahead to comment further on the details.

We would now be pleased to answer any questions you may have.

<u>Attachments</u>:

"Potential Costs of Weakening the Trade-Through Rule" NYSE Research, February, 2004
http://www.nyse.com/pdfs/tradethrough.pdf

NYSE Policy Perspective **"**The Trade-Through Rule: Protecting Investors, Helping Companies, and Preserving the Integrity of Markets" NYSE, February, 2004
http://www.nyse.com/pdfs/ttrpolicyperspective.pdf

NYSE®

Potential Costs of Weakening the Trade-through Rule

New York Stock Exchange Research
February 2004

Editor's Note: The trade-through rule, which ensures that America's 85 million investors can get the best price when trading stocks, is under attack. This research paper outlines the potentially significant costs to investors should the trade-through rule be weakened or eliminated.

For additional information about this important issue, please call NYSE Senior Vice President Robert McSweeney at 212-656-6766.

Potential Costs of Weakening the Trade-through Rule

February 2004

Background: Quoted Price Competition in NYSE-Listed Stocks

Companies listed on the New York Stock Exchange are traded on the New York and regional stock exchanges, Nasdaq dealers, and Electronic Communications Networks (ECNs). These various markets attract orders from stockbrokers by competitively quoting bid and ask prices, with orders flowing to the markets with the best-quoted prices. One or more markets can simultaneously quote the most competitive prices. Other markets may quote worse prices and consequently not receive many orders until their quotes improve. If a market center displays a better quote than is available on another market, then specialists and market makers are generally required by SEC regulation ("trade-through rule") to route orders to the market with the better price. This helps assure that investors receive the best available price. At the same time it encourages the competitive vitality of markets by assuring that investors who provide the most competitive quotes and priced limit orders do not have their orders ignored ("traded-through"). In today's market, most quotes reflect the public orders of customers, who are thus protected by the trade-through rule.

Benefit of the Trade-through Rule to Public Investors

How important is this trade-through rule? The answer depends significantly on how large a gap there is between the most competitively priced quotes versus other, less competitive quotes.

To measure this gap, we compared the national best and the national second-best quoted prices for the 93 NYSE-listed stocks in the S&P100 Index. The results are detailed in Table 1 and Figure 1 (pages 5 to 7):

- The best bid-offer price spreads are generally about 1 to 3 cents per share, with an average of 1.83 cents per share for the 93 stocks.
- The *second-best* bid-offer spread ranges from about 4 cents to over 20 cents per share, averaging 10.25 cents per share.
- If a buyer or seller of a stock had his or her order routed to trade at the second-best price, then this would **add an average cost of 4.21 cents per share** to the transaction. This additional transaction cost on public-customer orders would go to the dealer or trader who had quoted a worse price but nevertheless received and executed the order, while the most competitively priced orders are ignored.
- Significantly, in the absence of a trade-through rule, it is also possible that a market with *third-best* or *fourth-best* or even worse quotes would execute orders.

Quality of Markets with and without Trade-through Rules

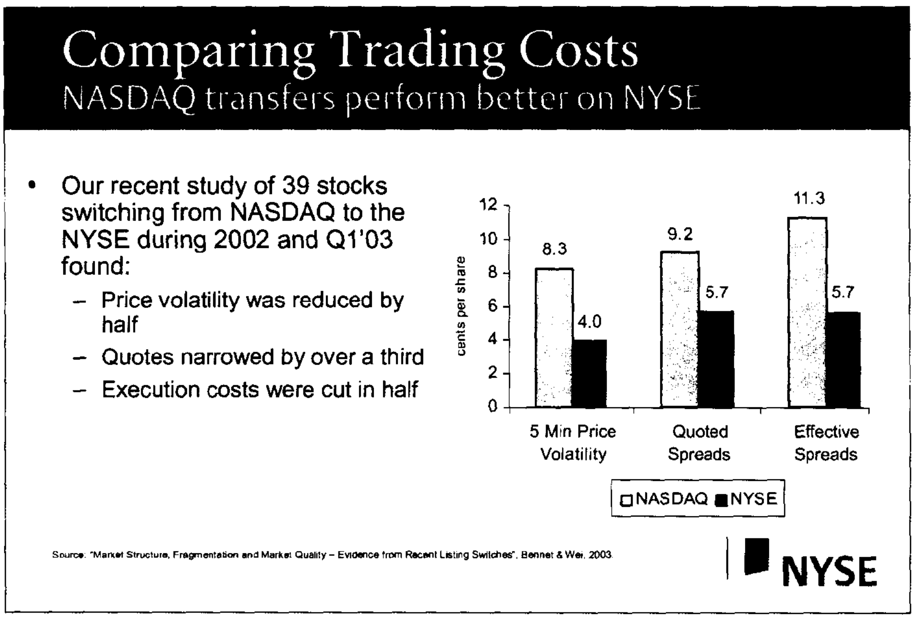
Stocks listed on the Nasdaq market are **not** subject to trade-through rules. This provides an opportunity to compare the quality of markets (NYSE listed versus Nasdaq listed) that result with a trade-through rule and without a trade-through rule. Such a comparison can be tricky because it is necessary to compare the same or very similar stocks to obtain meaningful results.

Academic research has developed two basic approaches:

(1) The first approach is to examine stocks that switched listings from Nasdaq to the NYSE, and compare their market quality before and after the switches. A recent study looked at:

- 39 stocks that switched listings between January 2002 and March 2003 (Figure 2).
- Quoted spreads for the exact same stocks trading on Nasdaq were about half as wide after the companies switched to the NYSE.
- This in turn translated into correspondingly lower execution costs on the NYSE compared to Nasdaq, as well as lower volatility of the publicly reported transactions prices.

Figure 2



(2) The second basic approach is to compare trading of carefully matched sets of stocks on the two markets.

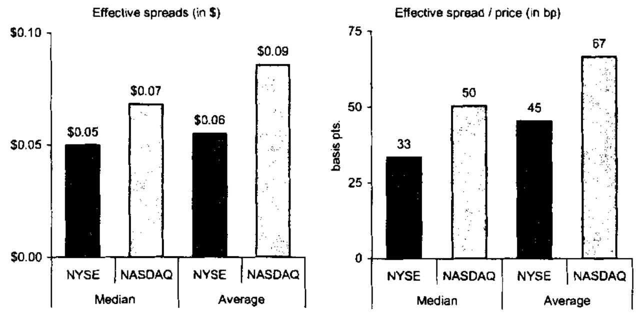
- A comparison conducted in May 2003 used the same matching criteria as in the 2001 SEC study of market quality to avoid methodological biases (Figure 3).
- The comparison showed that execution costs for the 249 NYSE-listed stocks, which are subject to the trade-through rule, averaged 45 basis points, compared with 67 basis points for the matched Nasdaq sample trading, which are not subject to the trade-through rule.
- These results echoed the findings of many earlier studies that showed trading in the listed market (subject to the trade-through rule) significantly lowers trading costs for investors.
- Other systematic comparisons also show that trading in NYSE-listed stocks provides lower execution costs. For example, Abel-Noser (Figure 4) estimates trading costs for very large orders, placed by institutional investors. NYSE-listed stocks have lower trading costs — which ultimately nets back to better results for pensioners and mutual fund investors who would bear the burden of relaxed trade-through rules.

Figure 3

Comparing Trading Costs

Better trade prices for comparable stocks

- Our recent study replicated the January 2001 SEC study, matching 249 pairs of stocks by controlling for differences in price, volume, market capitalization and other measures to create an apples-to-apples comparison.
- This methodology proves that NYSE stocks incur smaller trade costs than comparable NASDAQ stocks:



Effective spreads measure your trade execution price to the midpoint of the quoted spread, doubled. Lower effective spreads are better.

Source: NYSE and Market Systems Inc. SEC mandated average effective spreads for NYSE and NASDAQ stocks for November 2001 through December 2002. Criteria used to match stocks is identical to similar SEC study published in January 2001. 249 pairs of stocks matched in our study using this methodology.

NYSE

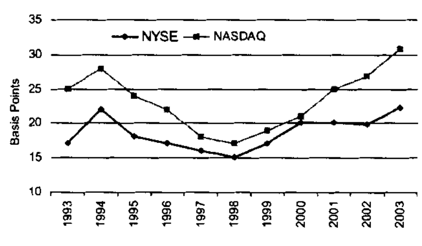
Figure 4

Institutional Trading Costs

Lower total trading costs for larger orders

- Abel/Noser estimates that total trading costs for institutional investors was 22 basis points (bps) through 2Q 2003 for NYSE stocks. Nasdaq stocks were 48 percent higher at 32 bps. Total trading costs take into account the market impact of trades, commissions, fees and other costs.

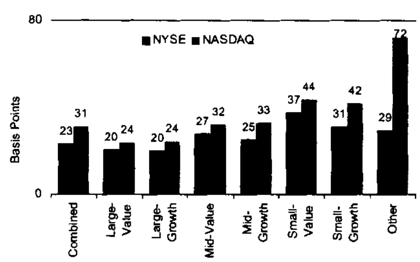
Historically lower costs overall...



Source: Abel/Noser Corp. - Q2 2003

Trading Costs = Execution Cost (Trade Price - VWAP) + Commission

and across all stock types



NYSE

Estimating the Cost to Investors

The cost to investors of relaxing the trade-through rule can be divided into scenarios. We assume that (consistent with current practice) four-fifths of total trading volume in NYSE-listed stocks would continue to trade on the NYSE and would, therefore, be unaffected by the rule change. As alternatives, we compute the cost of allowing 1-cent, 2-cent and 3-cent exemptions to the trade-through rule (i.e., shares trading off the NYSE could be executed for 1 to 3 cents worse prices than the National Best Bid or Offer prices). We also examine the scenario in which all off-NYSE trading migrates to the second-best price costing an extra 4.21 cents per share. The last scenario can be viewed as conservative because of the likelihood that third, fourth, or worse quotes would also attract orders.

Table 2 shows the scenario of steadily rising costs per year to investors, starting with $1.5 billion for the 1-cent exemption scenario and rising to $3.5 billion for the opt-out scenario (here conservatively assuming second-best quotes only are accessed).

In short, the cost to investors would be significant. In addition, if the exemption caused dealers to internalize more trades or send a larger fraction of orders to markets not observing trade-through provisions, the cost would be higher.

Table 2

Additional Cost to Investors
From Relaxing or Eliminating Trade-Through Rules
For NYSE-Listed Stocks Traded Off the NYSE*

Action on the Trade-Through Rule	Cost to Investors
1-cent Exemption**	$ 1,507,281,200
2-cent Exemption**	$ 2,299,369,458
3-cent Exemption**	$ 3,121,665,767
Complete Opt-Out (4.21 cents/share)**	$ 3,465,737,036

* *Assumes 20 percent of volume traded off the NYSE.*

** *2004 estimate of NYSE-listed off-exchange consolidated share volume.*

Table 1

National *Best* and *Second-best* Bid and Offer Prices for the 93 NYSE-Listed S&P 100 Stocks

NYSE-Listed S&P 100 Stock	National Best Bid ($)	National Best Offer ($)	National Best Spread (cents)	National Second-Best Bid ($)	National Second-Best Offer ($)	National Second-Best Spread (cents)	Cost to Investors without Trade-Through Rule (cents)
AA	34.65	34.67	1.69	34.61	34.70	9.06	3.69
AEP	28.15	28.17	2.01	28.12	28.20	8.56	3.27
AES	8.02	8.04	1.43	7.99	8.07	7.66	3.11
AIG	59.99	60.01	2.03	59.94	60.05	11.26	4.61
ALL	41.22	41.24	1.77	41.18	41.28	9.82	4.03
ATI	9.81	9.84	2.47	9.75	9.90	15.20	6.37
AVP	63.35	63.38	3.38	63.27	63.46	19.26	7.94
AXP	45.50	45.52	1.71	45.46	45.55	9.23	3.76
BA	38.89	38.91	1.88	38.86	38.95	9.17	3.65
BAC	75.71	75.73	1.73	75.68	75.76	7.85	3.06
BAX	29.68	29.69	1.89	29.62	29.73	10.51	4.31
BCC	30.26	30.28	2.08	30.18	30.34	16.37	7.14
BDK	48.07	48.09	2.28	47.98	48.15	16.56	7.14
BHI	30.28	30.29	1.66	30.24	30.33	8.90	3.62
BMY	26.12	26.13	1.45	26.09	26.16	7.08	2.82
BNI	31.04	31.06	1.87	30.98	31.10	11.94	5.04
BUD	52.42	52.44	2.00	52.37	52.48	10.71	4.36
C	47.35	47.37	1.37	47.34	47.38	4.60	1.61
CCU	44.16	44.18	1.85	44.11	44.22	10.89	4.52
CI	55.71	55.74	3.02	55.61	55.82	20.49	8.74
CL	53.10	53.12	2.12	53.05	53.17	11.64	4.76
CPB	25.90	25.92	1.87	25.84	25.97	13.17	5.65
CSC	41.70	41.73	2.88	41.62	41.80	18.14	7.63
DAL	11.47	11.49	1.58	11.43	11.53	10.00	4.21
DD	43.87	43.88	1.33	43.83	43.91	7.93	3.30
DIS	22.30	22.31	1.21	22.26	22.33	6.76	2.77
DOW	39.47	39.48	1.72	39.43	39.52	8.59	3.44
EK	23.84	23.85	1.38	23.80	23.88	7.99	3.30
EMC	12.68	12.69	1.10	12.67	12.71	3.98	1.44
EP	6.72	6.73	0.83	6.70	6.75	4.85	2.01
ETR	54.38	54.40	2.50	54.30	54.48	18.06	7.78
EXC	63.64	63.67	2.83	63.56	63.75	18.31	7.74
F	13.45	13.47	1.16	13.43	13.48	4.91	1.87
FDX	72.52	72.55	3.01	72.46	72.60	13.84	5.42
G	34.95	34.96	1.39	34.89	35.00	10.71	4.66
GD	84.67	84.71	3.84	84.61	84.77	16.91	6.53
GE	29.77	29.78	1.06	29.76	29.80	4.00	1.47
GM	48.50	48.52	1.54	48.47	48.55	8.44	3.45
GS	98.47	98.50	3.32	98.43	98.54	11.44	4.06
HAL	24.74	24.76	1.39	24.71	24.79	8.28	3.45
HCA	41.67	41.69	1.79	41.62	41.74	11.21	4.71
HD	34.26	34.27	1.25	34.23	34.30	6.81	2.78
HET	47.45	47.48	3.40	47.36	47.56	19.44	8.02
HIG	58.00	58.03	2.42	57.92	58.11	19.01	8.30
HNZ	36.16	36.18	1.66	36.11	36.23	11.59	4.97
HON	30.58	30.59	1.68	30.55	30.61	6.21	2.27
HPQ	22.22	22.23	1.26	22.20	22.26	5.61	2.18

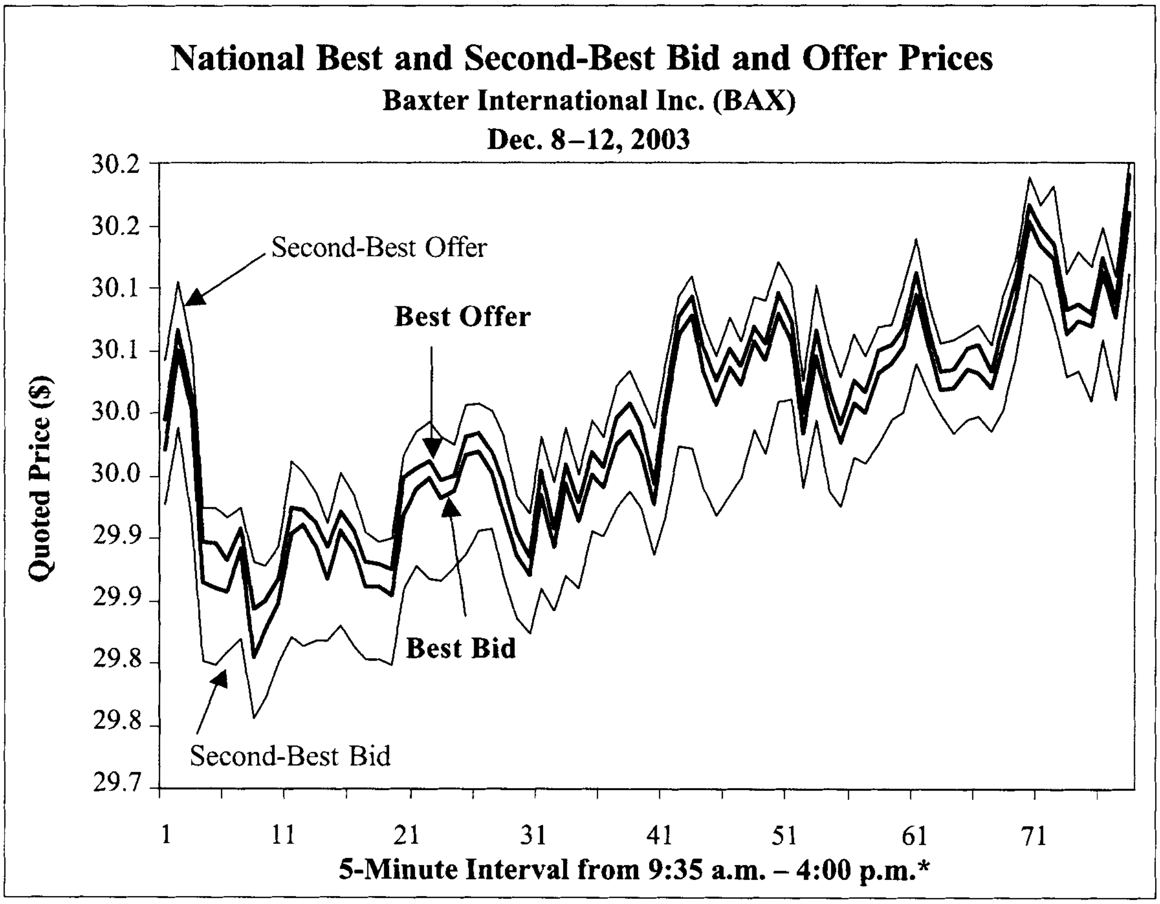
Table 1 (cont.)

NYSE-Listed S&P 100 Stock	National Best Bid ($)	National Best Offer ($)	National Best Spread (cents)	National Second-Best Bid ($)	National Second-Best Offer ($)	National Second-Best Spread (cents)	Cost to Investors without Trade-Through Rule (cents)
IBM	91.92	91.94	2.21	91.88	91.97	9.12	3.46
IP	40.55	40.57	1.73	40.51	40.61	10.13	4.20
JNJ	49.94	49.96	1.45	49.91	49.98	7.63	3.09
JPM	34.99	35.01	1.42	34.97	35.04	7.16	2.87
KO	48.10	48.11	1.44	48.06	48.14	8.43	3.49
LEH	71.94	71.97	3.18	71.90	72.02	11.78	4.30
LTD	17.50	17.52	1.67	17.44	17.56	12.13	5.23
LU	2.93	2.94	0.97	2.90	2.96	6.13	2.58
MAY	28.39	28.41	1.88	28.32	28.47	15.27	6.69
MCD	25.66	25.67	1.42	25.63	25.71	7.99	3.28
MDT	47.44	47.46	1.71	47.39	47.50	10.73	4.51
MER	55.52	55.54	2.18	55.47	55.58	10.86	4.34
MMM	81.46	81.48	2.26	81.41	81.53	11.43	4.58
MO	52.49	52.51	1.67	52.47	52.54	6.96	2.65
MRK	43.46	43.48	1.47	43.43	43.50	7.06	2.80
MWD	55.80	55.82	1.94	55.75	55.85	10.60	4.33
NSC	22.84	22.86	1.65	22.78	22.91	12.90	5.63
NSM	39.53	39.55	2.69	39.48	39.60	12.42	4.86
ONE	44.12	44.14	1.67	44.08	44.18	9.89	4.11
PEP	47.32	47.34	1.73	47.28	47.39	10.31	4.29
PFE	34.38	34.39	1.27	34.36	34.41	5.87	2.30
PG	96.45	96.47	1.98	96.40	96.51	10.68	4.35
ROK	34.57	34.60	2.57	34.48	34.67	19.09	8.26
RSH	28.68	28.70	1.86	28.61	28.77	16.41	7.28
RTN	28.68	28.70	2.35	28.61	28.75	13.38	5.51
S	46.99	47.01	1.94	46.94	47.05	11.05	4.55
SBC	24.36	24.37	1.25	24.33	24.40	6.29	2.52
SLB	49.90	49.91	1.49	49.85	49.95	10.11	4.31
SLE	20.98	21.00	1.43	20.95	21.02	7.24	2.91
SO	29.58	29.60	1.62	29.55	29.63	7.61	2.99
T	19.70	19.71	1.27	19.67	19.74	6.49	2.61
TOY	10.71	10.73	1.54	10.67	10.78	10.84	4.65
TWX	16.71	16.73	1.20	16.69	16.74	4.77	1.79
TXN	28.26	28.28	1.34	28.24	28.30	6.05	2.36
TYC	24.45	24.47	1.36	24.43	24.49	5.47	2.05
UIS	15.55	15.57	1.86	15.52	15.62	10.88	4.51
USB	27.84	27.85	1.45	27.80	27.88	7.73	3.14
UTX	89.15	89.17	2.50	89.10	89.22	11.86	4.68
VIAB	40.77	40.79	1.72	40.72	40.82	10.04	4.16
VZ	33.10	33.12	1.44	33.07	33.15	8.11	3.34
WFC	56.69	56.70	1.57	56.66	56.73	7.48	2.95
WMB	9.71	9.72	1.42	9.66	9.75	8.56	3.57
WMT	52.90	52.91	1.47	52.88	52.93	5.69	2.11
WY	59.99	60.02	2.57	59.92	60.08	16.72	7.07
XOM	37.67	37.69	1.20	37.64	37.71	6.34	2.57
XRX	11.91	11.93	1.40	11.88	11.95	6.79	2.70
Average	39.88	39.89	1.83 (cents)	39.83	39.93	10.25 (cents)	4.21 (cents)

Note: The intraday time period starts from 9:35 a.m. to avoid the unreasonable bid and offer from some market centers. Data are from week of Dec. 8–12, 2003.

Figure 1: Sample Stock

Comparing the National Best Quotes with the Second-Best Quotes



INFORMATION AND RESOURCES

NYSE Policy Perspective

The Trade-Through Rule:
Protecting Investors, Helping Companies, and Preserving the Integrity of Markets

Intermarket competition based upon best prices has benefited U.S. investors and contributed to making the market for NYSE-listed stocks the most liquid and efficient in the world. The trade-through rule, at the heart of the National Market System, is now under threat. Weakening or eliminating the rule could cost investors as much as $3.5 billion annually in increased execution costs. It would increase the volatility of markets, lessen transparency, and damage or destroy the intermarket system, which is central to maintaining competition across the markets and dealers in the United States.

What is the trade-through rule?
Bids and offers for NYSE-listed shares offered on the NYSE, as well as on Nasdaq, the regional exchanges, and ECNs, are linked together and visible to all market makers. The trade-through rule is intended to foster competition and transparency among all markets, while guaranteeing investors receive the best prices and the lowest execution costs when they buy or sell shares. The rule, while protecting investor interests, does not prevent broker/dealers or buy-side firms from sending customer orders in NYSE securities to other venues willing to compete on best price. In fact, 20% of the volume in NYSE stocks is currently executed in other markets.

Why does the trade-through rule matter to investors?
The trade-through rule protects investors from receiving something other than the best price when they trade their shares. Weakening of the trade-through rule would take away investors' assurances that their representatives are working to execute their trades at the best price. The difference between the best price and the second best price can be significant -more than 4 cents per share for the S&P100 stocks listed on NYSE. These additional expenses would affect all investors, large and small. But the brunt of them would be borne by small investors who are less able to monitor closely execution costs and to question their brokers or agents about prices received. Investors deserve and demand the highest quality order executions and the best price on their transactions.

Cost to Shareholders of Trading Through
NYSE Listed S&P100 Stocks (93 companies)
Average National Best and Second-best Bid and Offer Prices

NYSE Listed S&P100 Stock	National Best Bid ($)	National Best Offer ($)	National Best Spread (cents)	National Second Best Bid ($)	National Second Best Offer ($)	National Second Best Spread (cents)	Cost to Investors without Trade Through Rule (cents)
Average	39.88	39.89	1.83 (cents)	39.83	39.93	10.25 (cents)	4.21 (cents)

Note: Based on intra-day price quotes for week of December 8-12, 2003.

Why does the trade-through rule matter to companies?
NYSE-listed companies currently enjoy the advantages of head-to-head price competition — where all buyers and sellers bid against one another in real time for shares, rather than in a fragmented system where different clusters of traders transact at different prices in the same security. Companies benefit since their share prices are less volatile and more reflective of fundamentals. Owners find that their holdings are more liquid. Retail investors are not pushed aside by buyers and sellers of very large positions, and the same prices apply to all. Quoted bid-ask spreads are narrower in the marketplace for NYSE stocks, lowering execution costs and particularly benefiting medium and smaller companies. Companies with more liquid securities are thus able to raise new capital in IPOs or in secondary offerings in a market place that brings together the largest number of buyers and sellers within a unified pricing mechanism.

Why is the trade-through rule good public policy?
The trade-through rule promotes both best price and competition among markets. Eliminating or diluting the trade-through rule would mean a return to the uncoupled markets of 30 years ago. It

would weaken competition and transparency by licensing each market to ignore better prices elsewhere. It would increase the likelihood that intermediaries charged with managing households' wealth would put their own convenience or interests above that of their clients; more freely engaging in practices such as internalization and payment for order flow, which increase their own profitability at the expense of investors. It would seriously impair the fair and accurate price discovery and stock valuation. And at the end of the day, the trade through rule is about preserving a principle at the core of our markets: the ultimate investor must always get the best price.

What is the NYSE Committed to Doing for Customers?

- We will continue to compete with other markets for trading of NYSE-listed shares, striving to provide the narrowest spreads and best price for investors. At present, the NYSE posts the best price 93% of the time. But where we do not offer the best price, we are committed to sending orders to the market which does.
- We will provide customers with the widest choice of order execution services. Thanks to our blend of advanced technology and the agency auction process, we can offer everything from automatic executions to a floor auction, which produces an improvement in price on nearly one-third of all transactions.
- We will provide the benefits associated with the specialists' role in bringing together buyers and sellers, ensuring liquidity and accountability, and dampening volatility, in addition to the agency floor brokers' role of representing large orders over time to reduce market impact.
- We will provide a regulatory infrastructure that promotes fairness for all investors, large and small, and puts the interests of investors as our first priority.

To download the above Policy Perspective as a .pdf, click here.

Attachment: Potential Costs of Weakening the Trade-through Rule, NYSE Research, February, 2004 (.pdf)

Related Reading

March 5, 2004: Individual Investor Advisory Committee Chairman, Kurt Stocker: *What Do America's Investors Want?*

February 26, 2004: USA Today, letter to the editor from Individual Investor Advisory Committee Chairman, Kurt Stocker: *Trading-rule change cheats investor*

February 24, 2004 SEC Press Release: SEC to Publish Regulation NMS for Public Comment

In February, 2004, Richard A. Rosenblatt, CEO, and Joseph C. Gawronski, COO, of Rosenblatt Securities examined the facts of the way the trade-through rule operates, as well as the empirical evidence, to dispel the four biggest myths surrounding the rationale for the repeal or relaxation of the trade-through rule in their *Traders Magazine* article, "Debunking the Myths of the Trade-Through Rule: A View from an Agent." (.pdf)

More research material