

TESTIMONY OF MR. KIM BANG
PRESIDENT AND CHIEF EXECUTIVE OFFICER
BLOOMBERG TRADEBOOK LLC
BEFORE THE SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND
GOVERNMENT SPONSORED ENTERPRISES
HOUSE COMMITTEE ON FINANCIAL SERVICES
REGARDING
“THE SEC PROPOSAL ON MARKET STRUCTURE: HOW WILL INVESTORS
FARE?”
MAY 18, 2004

INTRODUCTION. MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE. MY NAME IS KIM BANG, AND I AM PLEASED TO TESTIFY ON BEHALF OF BLOOMBERG TRADEBOOK REGARDING “THE SEC PROPOSAL ON MARKET STRUCTURE: HOW WILL INVESTORS FARE?” THE TOPIC IS BOTH IMPORTANT AND TIMELY.

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 175,000 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 FUND 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. OUR CLIENTS HAVE REWARDED OUR CREATIVITY AND OUR SERVICE BY TRUSTING US WITH THEIR BUSINESS, ENABLING US TO REGULARLY TRADE MORE THAN 150 MILLION SHARES A DAY.

REGULATION NMS. 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 LANDMARK "REGULATION NMS" PROPOSAL IS WELCOME AND WARRANTED.

THE SEC IS TO BE COMMENDED FOR ISSUING PROPOSED REGULATION NMS FOR PUBLIC COMMENT. THE REGULATION 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.

IN EARLIER MARKET STRUCTURE HEARINGS, CHAIRMAN OXLEY 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 — THERE HAVE BEEN AND CONTINUE TO BE NUMEROUS IMPEDIMENTS TO ELECTRONIC COMPETITORS.

FROM THE ONLY RECENTLY DISCARDED RULE 390, WHICH SUBSTANTIALLY RESTRICTED NYSE MEMBER FIRMS FROM TRADING STOCKS OF COMPANIES THAT LISTED BEFORE APRIL 1979 ANYWHERE BUT ON THE EXCHANGES, TO THE NOW RESCINDED RULE 500, WHICH MADE IT EXTREMELY DIFFICULT FOR A LISTED COMPANY TO DELIST, THESE

BARRIERS HAVE HAD THE EFFECT OF CENTRALIZING ORDER FLOW, AND IMPAIRING INTER-MARKET COMPETITION.

THE NASDAQ PRICE-FIXING SCANDAL OF THE MID 1990S RESULTED IN SANCTIONS BY THE SEC AND THE DEPARTMENT OF JUSTICE AND DECISIONS ON MARKET STRUCTURE INTENDED TO ENHANCE TRANSPARENCY AND COMPETITION IN THE NASDAQ MARKET. SPECIFICALLY THE SEC'S 1996 ISSUANCE OF THE ORDER-HANDLING RULES PERMITTED ELECTRONIC COMMUNICATIONS NETWORKS — ECNS — TO FLOURISH, BENEFITING INVESTORS AND ENHANCING THE QUALITY OF THE MARKET.

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 CONGRESS IS WHETHER OUR EQUITY MARKETS CAN BE REFORMED TO BRING THE SAME

BENEFITS TO THE NYSE INVESTOR AS THEY HAVE TO THE NASDAQ INVESTOR. THE TRADE-THROUGH RULE IS THE FOREMOST IMPEDIMENT TO THAT OPPORTUNITY.

THE TRADE-THROUGH RULE. 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. TWENTY YEARS AGO INVESTORS DID NOT HAVE DIRECT MARKET ACCESS AND COULDN’T CHOOSE BETWEEN PRICE, LIQUIDITY AND SPEED, BECAUSE SOPHISTICATED ROUTING AND EXECUTION TECHNOLOGY DID NOT EXIST. TODAY, TECHNOLOGY PROVIDES THOSE OPTIONS, BUT THE TRADE-THROUGH RULE STYMIES CHOICE AND COMPETITION — FORCING INVESTORS TO GO THROUGH SLOWER, MANUAL MARKETS WITH INFERIOR AND MORE EXPENSIVE EXECUTION RESULTS.

THAT MAY HAVE MADE SOME SENSE BEFORE SYSTEMS AUTOMATION AND DECIMALIZATION — WHEN THERE WERE ONLY MANUAL MARKETS AND EIGHT PRICE POINTS PER DOLLAR. TODAY, ORDER ROUTING TECHNOLOGY ENABLES SPEED AND CERTAINTY OF EXECUTION THAT IS MORE IMPORTANT TO MOST INVESTORS THAN ATTEMPTING TO CAPTURE THE LAST PENNY. CERTAINTY OF EXECUTION

FAR OUTWEIGHS THE RISK OF MISSING THE PRICE AND LOSING THE TRADING OPPORTUNITY ALTOGETHER.

CURRENTLY, THE INTERMARKET TRADING SYSTEM TRADE-THROUGH RULE PROTECTS INEFFICIENT MARKETS WHILE DEPRIVING INVESTORS OF THE CHOICE OF ANONYMITY, SPEED OR LIQUIDITY BY MANDATING INSTEAD THAT INVESTORS PURSUE THE ADVERTISED THEORETICAL “BEST PRICE” INSTEAD OF THE BEST AVAILABLE FIRM PRICE.

ONE QUESTION THAT PUZZLES US IS WHY IT SEEMS THE EXISTING RULE — AND THE SEC’S PROPOSED RULE AS WELL — FAIL TO PROTECT LIMIT ORDERS IN AT LEAST THREE WAYS:

1. THEY DO NOT ACCORD TIME PRIORITY TO LIMIT ORDERS THAT HAVE ALREADY BEEN PLACED;

2. THEY PERMIT ANOTHER MARKET CENTER TO “MATCH” PRE-EXISTING LIMIT ORDERS—WHICH EFFECTIVELY DENIES LIMIT ORDER ENTRANTS THE REWARD THEY SHOULD GET FOR, IN EFFECT, HAVING GRANTED THE MARKET FREE “OPTIONS” (PUTS IN THE CASE OF A LIMIT ORDER TO BUY, CALLS IN THE CASE OF A LIMIT ORDER TO SELL). THAT PERMITS EXCHANGES SUCH AS THE NYSE TO MATCH AND THEN

INTERNALIZE ORDERS RATHER THAN TO SHIP THEM TO OTHER MARKET CENTERS THAT HAD OFFERED BETTER PRICES; AND

3. LIMIT ORDERS ARE NOT PROTECTED AGAINST “PENNYING” — BY WHICH NYSE SPECIALISTS AND OTHER FLOOR MEMBERS JUMP AHEAD OF ORDERS BY TRIVIAL AMOUNTS — A PENNY OR TWO. THIS IS ONE OF THE NEGATIVE FALLOUTS OF THE MOVE TO DECIMAL MARKETS.

WE SHARE WITH SINCERE PROPONENTS OF TRADE-THROUGH RULES A VISION OF A NATIONAL MARKET SYSTEM THAT PROMOTES ORDER INTERACTION AND TREATS ALL ORDERS AND ALL INVESTORS FAIRLY. WE EMBRACE WHOLEHEARTEDLY A MARKET STRUCTURE THAT PROTECTS ALL PARTICIPANTS, LARGE AND SMALL. 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 AND IS AN IMPEDIMENT TO ACHIEVING BEST EXECUTION. IT HAS STOOD IN THE WAY OF INNOVATIVE TECHNOLOGY AND DETERRED INVESTORS FROM OBTAINING DIRECT ACCESS TO MARKET DATA AND LIQUIDITY. AS ARCHIPELAGO’S GERALD PUTNAM HAS TESTIFIED BEFORE THIS COMMITTEE:

. . . EMPIRICAL DATA SHOWS THAT THE NYSE TROTS OUT THE TRADE THROUGH RULE WHEN IT SUITS ITS COMPETITIVE PURPOSES, BUT IGNORES IT WHEN IT DOES NOT. HERE ARE SOME FACTS: ARCAEX RUNS SOFTWARE (APPLY NAMED "WHINER") THAT MESSAGES ALERTS WHEN EXCHANGES TRADE THROUGH AN ARCAEX QUOTE IN VIOLATION OF THE ITS PLAN. THE WHINER DATABASE REFLECTS THAT ARCAEX CUSTOMERS SUFFERED UP TO 7,500 TRADE-THROUGH VIOLATIONS IN A SINGLE WEEK BY THE NYSE. IN FACT, TRADE-THROUGH VIOLATIONS HAVE ACTUALLY RISEN MOST RECENTLY DESPITE THE GLARE OF THE REGULATORY SPOTLIGHT ON THE NYSE. SINCE JUST THIS LAST THE [SIC] FALL (2003), THE ANNUALIZED COST TO INVESTORS OF THE NYSE SPECIALISTS TRADING THROUGH ARCAEX'S QUOTES HAS INCREASE 3-FOLD FROM APPROXIMATELY \$1.5 MILLION TO \$5 MILLION. ON ANY GIVEN DAY, ARCAEX HAS A BILLION SHARES ON OR NEAR THE NATIONAL BEST BID OR OFFER. YET ON ANY GIVEN DAY, THE NYSE SENDS ONLY 2 MILLION SHARES TO ARCAEX OVER ITS WHEN WE HAVE THE BEST PRICE.

WE HAVE CONFRONTED THE NYSE WITH OUR VOLUMINOUS DATA BUT TO NO AVAIL. IF, IN THE NYSE'S OWN WORDS, THE TRADE THROUGH RULE "SERVES TO PROTECT INVESTORS," THEN THE NYSE HAS SOME "SPLAINING" TO DO AND NEEDS TO TAKE CORRECTIVE

ACTION FORTHWITH TO ENFORCE AND COMPLY WITH THE TRADE THROUGH RULE IN ITS OWN MARKETPLACE.¹

THE TRADE-THROUGH RULE IN PRACTICE HAS BEEN A ONE-WAY STREET, WITH THE NYSE ITSELF AS THE HEAVY-HANDED TRAFFIC COP. TO BE SURE, THE NYSE GOES AFTER REGIONAL MEMBERS THAT TRADE THROUGH NYSE PRICES. NONETHELESS, THE NYSE'S SPECIALISTS ROUTINELY TRADE THROUGH BETTER PRICES ON OTHER MARKETS AND, AS A PRACTICAL MATTER, THEY DO SO WITH IMPUNITY.

FOR THEIR PART, THE REGIONAL MARKET CENTERS TEND TO COMPLY WITH THE CURRENT TRADE-THROUGH RULE WHILE AT THE SAME TIME THEY ARE NOT ABLE TO PROTECT THEIR CLIENT LIMIT ORDERS FROM BEING TRADED THROUGH BY THE PRIMARY MARKET. THEY ARE FURTHER DISADVANTAGED BECAUSE THEY ARE NOT PERMITTED TO EXECUTE INCOMING ORDERS ROUTED FOR EXECUTION AGAINST THEIR CUSTOMER LIMIT ORDERS WHEN THOSE ORDERS ARE DISPLAYED AND AVAILABLE, BUT AWAY FROM THE NBBO. THE INTERMARKET TRADING SYSTEM TRADE-THROUGH RULE REQUIRES THAT

¹ Written statement of Gerald Dean Putnam, Chairman & Chief Operating Officer, Archipelago Holdings, L.L.C., concerning "Market Structure III: The Role of the Specialist in the Evolving Modern Marketplace" before Committee on Financial Services -- Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, United States House of Representatives, 108th Cong., 2d Sess., February 20, 2004, at p. 6

REGIONAL EXCHANGES AND ECNS REROUTE THOSE ORDERS TO THE PRIMARY EXCHANGE.

IN THE CASE OF NASDAQ-LISTED STOCKS, WE AT BLOOMBERG TRADEBOOK HAVE PLENTY OF PRACTICAL EXPERIENCE WITH HOW AND WHEN OUR CLIENTS CHOOSE TO TRADE THROUGH PUBLISHED PRICES. IN OUR EXPERIENCE, THE ONLY MARKET CENTERS OUR CLIENTS REGULARLY CHOOSE TO TRADE THROUGH OR AROUND ARE THE AMERICAN STOCK EXCHANGE (THE "AMEX") AND CERTAIN ECNS. OUR CLIENTS TRADE AROUND THE AMEX BECAUSE THE AMEX POSTS INDICATIVE QUOTATIONS AND IS SLOW TO RESPOND TO ORDERS. SOME OF OUR CLIENTS TRADE AROUND ONE OR TWO SMALLER ECNS THAT CHARGE EXORBITANT ACCESS FEES.

BEFORE THE ADVENT OF SUPERMONTAGE, IT WAS COMMON PRACTICE FOR OUR CLIENTS TO PREFERENCE ECNS FOR THEIR IMMEDIACY. AT THE TIME, NASDAQ DISPLAYED INDICATIVE MARKET-MAKER QUOTATIONS THAT WERE NOT AUTOMATICALLY EXECUTABLE. OFTEN, THE MARKET MAKERS TOOK UP TO 30 SECONDS TO EXECUTE OR DECLINE AN ORDER. EVEN THEN, IT WAS RARE FOR OUR CLIENTS TO COMPLETELY IGNORE OR TRADE THROUGH MARKET-MAKER QUOTATIONS. RATHER, THE MARKET MAKERS TENDED TO RECEIVE A PROPORTIONATELY SMALLER AMOUNT OF ORDER FLOW. THAT

OCCURRED BECAUSE, COMPARED WITH ECN ORDERS, THEIR QUOTATIONS WERE LESS FIRM. WITH THE SUBSEQUENT LAUNCH OF SUPERMONTAGE, MARKET MAKER QUOTATIONS HAVE BEEN CONVERTED TO ORDERS AND ARE NOW FIRM. AS A RESULT, OUR CLIENTS TREAT SUPERMONTAGE ORDERS ON EQUAL FOOTING WITH ECN LIMIT ORDER BOOKS.

THE TECHNOLOGY IS IN PLACE. THE ORDER-MANAGEMENT SYSTEMS, ORDER-ROUTING TECHNOLOGIES, CONNECTIVITY AND SERVICE BUREAUS THAT BROKERS AND INVESTORS TODAY WIDELY EMPLOY LET THEM REACH EVERY LIQUIDITY VENUE. THESE SYSTEMS ARE DESIGNED FOR BROKERS AND INVESTORS TO SEEK BEST EXECUTION AT THE LOWEST COST. THESE SYSTEMS LET TRADERS PREFERENCE OR PRIORITIZE ORDERS ON THE BASIS OF COST, RESPONSE TIMES AND OTHER RELEVANT LIQUIDITY PARAMETERS. IN OUR EXPERIENCE, INVESTORS DO NOT ROUTINELY TRADE THROUGH FAST MARKETS. ONLY SLOW MARKETS ROUTINELY TRADE THROUGH FAST MARKETS — AND THAT IS NOT BECAUSE THEY CANNOT ACCESS FAST MARKETS. IT IS BECAUSE THEY CHOOSE NOT TO.

IF TRADE-THROUGH PROTECTION FOR FAST MARKETS IS NOT NECESSARY AS A GENERAL MATTER, THEN A *DE MINIMIS* TRADE-THROUGH RULE, THAT IS, A TRADE-THROUGH RULE THAT ALLOWS A FAST MARKET TO TRADE THROUGH A SLOW ONE BY JUST A LITTLE BIT, ALSO IS

UNNECESSARY. IN A MARKETPLACE WHERE BROKERS AND FIDUCIARIES ARE OBLIGATED TO SEEK BEST EXECUTION, THE REGULATORY AND FINANCIAL INCENTIVE IS IN PLACE TO SEEK THE BEST PRICE. THE PROGRAMMING REQUIRED BY THE MARKET CENTERS TO ENSURE THAT NO TRADE-THROUGH OCCURS AMOUNTS TO EXPENSIVE REGULATORY AND SYSTEMS OVERKILL WITH NO COMMENSURATE BENEFIT TO INVESTORS.

INDEED, THE COMMISSION'S OWN PRELIMINARY ESTIMATES OF THE SECURITIES INDUSTRY'S COSTS OF COMPLIANCE WITH THE PROPOSED TRADE-THROUGH RULE ARE EYE-POPPING. START-UP COSTS ARE PROJECTED TO RUN IN EXCESS OF \$540 MILLION, WHILE ANNUAL, ONGOING COSTS OF COMPLIANCE ARE PROJECTED AT NEARLY \$224 MILLION.

A TRADE-THROUGH RULE, IN ADDITION TO BEING WASTEFUL, MAY ALSO BE HARMFUL TO INVESTORS. CONSIDER FIRST THAT SLOW MARKETS WILL FREELY CHOOSE TO BE SLOW MARKETS. THERE MAY BE LITTLE INCENTIVE FOR A MARKET TO ELECT TO BECOME A FAST MARKET IF SLOW MARKETS ARE TO RECEIVE TRADE-THROUGH PROTECTION—EVEN DE MINIMIS PROTECTION. SUCH SLOW MARKETS MAY HAVE GENUINE BENEFITS FOR PARTICIPANTS IN TERMS OF PRICE FORMATION AND LIQUIDITY. BUT THESE BENEFITS OUGHT TO ACCRUE ONLY AS THE

RESULT OF COMPETITION. THAT WOULD MEAN THAT THE SLOW MARKET PARTICIPANTS THEMSELVES WOULD HAVE TO BEAR THE ATTENDANT COST, FOR EXAMPLE, IN THE FORM OF MISSED TRADING OPPORTUNITIES. THE ALTERNATIVE WOULD BE TO PERPETUATE TRADE-THROUGH RULES THAT WOULD ALMOST CERTAINLY IMPOSE A MUCH HIGHER COST THAT WILL CONTINUE TO BE BORNE BY THE ENTIRE INVESTOR UNIVERSE OF FAST MARKET PARTICIPANTS.

TO BE SURE, ONLY SLOW MARKETS THAT OFFER REAL BENEFITS WILL BE WORTH THE SACRIFICE OF FAST-MARKET TRADING OPPORTUNITIES. IN OPEN COMPETITION, THE BENEFITS WILL HAVE TO OUTWEIGH THE COSTS. THE FAIREST WAY TO FACILITATE THAT RESULT IS TO PROMOTE ENHANCED INVESTOR AND FIDUCIARY CHOICE AND HAVE THEM BEAR THE COSTS AND REGULATORY RISK OF THEIR OWN BEST EXECUTION CHOICES.

IF THE TRADE-THROUGH RULE WERE ABOLISHED FOR STOCKS LISTED ON THE NYSE, WE EXPECT OUR CLIENTS WOULD PREFERENCE THE FAST-MARKET VENUES (FIRM QUOTATIONS), BUT WOULD NOT IGNORE SLOW MARKETS (INDICATIVE QUOTATIONS) TO THE EXTENT THEY AFFORDED AVAILABLE LIQUIDITY. FAST MARKETS WOULD AUTOMATICALLY EXECUTE AGAINST THEIR LIMIT ORDER BOOKS AND REFRESH THEIR QUOTATIONS IMMEDIATELY AND THEREBY EARN

PROPORTIONATELY MORE ORDER FLOW OVER TIME. ORDERS RESIDING ON THE SLOW MARKETS BEYOND THE TOP-OF-FILE AND HIDDEN ORDERS IN THE CROWD WOULD BE TRADED THROUGH, AND RIGHTLY SO. IF THE TRADE-THROUGH RULE WERE ELIMINATED, THE OPTION THAT SPECIALISTS CURRENTLY ENJOY, WHICH IS BOTH RISKLESS AND FREE, TO INTERCEPT INCOMING ORDERS, TO JUMP AHEAD BY A PENNY OR TO “GO ALONG” WITH INSTITUTIONAL ORDERS, WOULD BE DIMINISHED. SPECIALISTS WOULD THEN HAVE TO COMPETE ON AN EVEN BASIS WITH OTHER MARKET PARTICIPANTS TO SATISFY INVESTORS’ DEMANDS FOR BEST EXECUTION.

REMOVING THE TRADE-THROUGH RULE WOULD ALLOW INVESTORS TO CHOOSE THE MARKETS IN WHICH THEY WISH TO TRADE WHICH WOULD, IN TURN, PROMOTE COMPETITION AND BENEFIT INVESTORS. THE RESULTS WOULD BE GREATER TRANSPARENCY, GREATER EFFICIENCY, GREATER LIQUIDITY AND LESS INTERMEDIATION IN THE NATIONAL MARKET SYSTEM, WHICH ARE PRECISELY THE GOALS OF THE SECURITIES ACTS AMENDMENTS OF 1975.

AS A RESULT, WE BELIEVE THE BEST OUTCOME FOR THE MARKETS WOULD BE FOR THE COMMISSION TO ELIMINATE THE TRADE-THROUGH RULE ENTIRELY. IF THERE IS TO BE A TRADE-THROUGH RULE, HOWEVER, IT IS ESSENTIAL THAT THERE BE OPT OUTS. AN OPT OUT IS NECESSARY

TO PERMIT BROKERS AND FIDUCIARIES TO MEET THEIR BEST EXECUTION OBLIGATIONS.

THE ALTERNATIVE OPT-OUT PROVISION, FOR FAST MARKETS OPTING OUT OF SLOW MARKETS WITHIN A STATED PRICE BAND, RAISES SOME ISSUES. JUST AS THE SHORT SALE RULE PRESENTS PRACTICAL PROBLEMS IN A DECIMALIZED MARKET CHARACTERIZED BY FLICKERING QUOTES, WE WONDER WHETHER THE FAST-TO-SLOW OPT OUT WOULD PRESENT A SIMILAR OR EVEN GREATER PROBLEM OF IMPLEMENTATION. THE SLIDING SCALE OF PERMISSIBLE TRADE-THROUGH PRICING WOULD MAKE IMPLEMENTATION ALL THE MORE COMPLICATED. ALSO, WE WONDER WHETHER IT IS SENSIBLE FOR THE GOVERNMENT TO DECREE WHAT IS FAST ENOUGH TO BE FAST. A MARKET-DRIVEN DETERMINATION MIGHT WELL RELY ON COMPETITION AMONG MARKET CENTERS TO EMBRACE TECHNOLOGY IN PLACE OF A GOVERNMENT MANDATE.

IF THE COMMISSION WERE TO WITHDRAW THE UNRESTRICTED OPT OUT IN FAVOR OF THE FAST-TO-SLOW OPT OUT, WE THINK THE CURRENT EXEMPTION FOR BLOCK TRADES SHOULD BE RETAINED GIVEN THE LIMITATIONS OF PUBLISHED LIQUIDITY.

IF THERE IS TO BE A TRADE-THROUGH RULE, A SOLUTION WILL HAVE TO BE FOUND TO PREVENT MARKET CENTERS FROM REJECTING

AND REROUTING ORDERS THEY HAVE MISPERCEIVED AS TRADE THROUGHES. IF THIS PROBLEM WERE SOLVED, IT MIGHT SUBSTANTIALLY DIMINISH THE NEED FOR AN OPT OUT.

RATHER THAN INTRODUCING A COMPLEX AND EXPENSIVE NEW TRADE-THROUGH RULE THAT WOULD BE DIFFICULT TO ENFORCE, WE SUGGEST LAUNCHING A PILOT PROGRAM SIMILAR TO THE ETF DE MINIMIS EXEMPTION FROM THE TRADE THROUGH FOR A CROSS SECTION OF LISTED STOCKS, WITH NO TRADE-THROUGH RESTRICTIONS. THE COMMISSION COULD THEN MONITOR AND MEASURE THE RESULTS OF FREE COMPETITIVE FORCES.²

MARKET DATA THE FINANCIAL SERVICES COMMITTEE HAS LONG HELD THAT MARKET DATA IS THE “OXYGEN” OF THE MARKETS. ENSURING 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.

² See Hendershott and Jones, “Trade-Through Prohibitions and Market Quality”, unpublished working paper (April 8, 2004) at p.8, available at <http://faculty.haas.berkeley.edu/hender/> (“There is no evidence that market quality worsens when the trade-through rule is relaxed. In fact, overall effective spreads actually fall for all three ETFs, and the fall is statistically significant for DIA and QQQ.”)

The Commission would be able to monitor the execution quality from filings under Rule 11Ac1-5.

BEFORE THE 1970S, NO STATUTE OR RULE REQUIRED SELF-REGULATORY ORGANIZATIONS (SROS) TO DISSEMINATE MARKET INFORMATION TO THE PUBLIC OR TO CONSOLIDATE INFORMATION WITH INFORMATION FROM OTHER MARKET CENTERS. INDEED, THE NYSE, WHICH OPERATED THE LARGEST STOCK MARKET, CLAIMED AN OWNERSHIP INTEREST IN MARKET DATA, SEVERELY RESTRICTING ACCESS TO MARKET INFORMATION. MARKETS AND INVESTORS SUFFERED FROM THIS LACK OF TRANSPARENCY.

AT THE URGING OF THE SEC, CONGRESS RESPONDED BY ENACTING THE SECURITIES ACTS AMENDMENTS OF 1975. THESE AMENDMENTS EMPOWERED THE SEC TO FACILITATE THE CREATION OF A NATIONAL MARKET SYSTEM FOR SECURITIES, WITH MARKET PARTICIPANTS REQUIRED TO PROVIDE — IMMEDIATELY AND WITHOUT COMPENSATION — INFORMATION FOR EACH SECURITY THAT WOULD THEN BE CONSOLIDATED INTO A SINGLE STREAM OF INFORMATION.

AT THE TIME, CONGRESS CLEARLY RECOGNIZED THE DANGERS OF DATA-PROCESSING MONOPOLIES. THE REPORT ACCOMPANYING THE 1975 AMENDMENTS EXPRESSLY WARNS THAT:

PROVISION MUST BE MADE TO INSURE THAT THIS CENTRAL PROCESSOR IS NOT UNDER THE CONTROL OR DOMINION OF ANY

PARTICULAR MARKET CENTER. ANY EXCLUSIVE PROCESSOR IS, IN EFFECT, A PUBLIC UTILITY, AND THUS IT MUST FUNCTION IN A MANNER WHICH IS ABSOLUTELY NEUTRAL WITH RESPECT TO ALL MARKET CENTERS, ALL MARKET MAKERS, AND ALL PRIVATE FIRMS.³

EVEN AS NOT-FOR-PROFIT ENTITIES, SROS HISTORICALLY HAVE EXPLOITED THE OPPORTUNITY TO SUBSIDIZE OTHER COSTS (E.G., EXECUTIVE COMPENSATION, COST OF MARKET OPERATION, MARKET REGULATION, MARKET SURVEILLANCE, MEMBER REGULATION) THROUGH THEIR GOVERNMENT-SPONSORED MONOPOLY ON MARKET INFORMATION FEES. WHILE THIS SUBSIDY IS TROUBLING ENOUGH, THE INCENTIVE TO EXPLOIT THIS MONOPOLY POSITION WILL BE EVEN STRONGER AS SROS CONTEMPLATE FOR-PROFIT FUTURES AND NEW LINES OF BUSINESS.

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

³ Report of the Senate Comm. on Banking, Housing, and Urban Affairs to accompany s.249, S. Rep. no. 94-75, 94th Cong., 1st Sess. 11 (1975).

DATA ARE COLLECTED AND DISSEMINATED. IN THAT 1999 RELEASE, THE SEC PROPOSED A COST-BASED LIMIT TO MARKET DATA REVENUES. 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 PROPOSES A NEW FORMULA FOR DISPENSING MARKET DATA REVENUE WITHOUT ADDRESSING THE UNDERLYING QUESTION OF HOW TO EFFECTIVELY REGULATE THIS MONOPOLY FUNCTION.

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.

UNDER THE CURRENT SYSTEM, MARKET DATA REVENUES PROVIDE SROS WITH FUNDS TO COMPETE WITH OTHER EXECUTION CENTERS. FOR EXAMPLE, ARCHIPELAGO HOLDINGS (“ARCHIPELAGO”) RECENTLY FILED AN IPO REGISTRATION STATEMENT WITH THE COMMISSION IN WHICH IT REPORTED SOME \$23 MILLION FOR 2003 REVENUE FROM MARKET DATA. THIS WAS NET OF \$7.5 MILLION PAID TO THE PACIFIC STOCK EXCHANGE

FOR MARKET REGULATION SERVICES. ARCHIPELAGO FURTHER STATED THAT IT USES THIS REVENUE TO COMPETE WITH NASDAQ, THE NYSE AND ECNS, SUCH AS BLOOMBERG TRADEBOOK. THAT IS, THE MARKET DATA REVENUES ARCHIPELAGO RECEIVES AS AN EXCHANGE ARE, IN EFFECT, GOVERNMENT-SANCTIONED SUBSIDIES THAT CONFER AN UNFAIR COMPETITIVE ADVANTAGE ON ARCHIPELAGO AND SIMILARLY SITUATED SROS.

THE COMMISSION'S PROPOSAL WITH RESPECT TO MARKET DATA WOULD PERPETUATE THE EXCLUSIVE AND LUCRATIVE FRANCHISE SROS ENJOY OVER THE COLLECTION, DISSEMINATION AND SALE OF MARKET DATA. AS SUCH, THE COMMISSION HAS A STATUTORY DUTY TO ENGAGE IN RATEMAKING PROCEEDINGS WITH RESPECT TO THESE GOVERNMENT-SANCTIONED MONOPOLIES. IT IS TRULY NECESSARY FOR THE COMMISSION TO ASSESS THE FAIRNESS AND REASONABLENESS OF THE NYSE AND NASDAQ MARKET DATA FEES — FEES FOR WHAT ARE ESSENTIALLY MONOPOLY SERVICES. IF THOSE FEES ARE EXCESSIVE OR POORLY STRUCTURED, THEY MAY HAVE CREATED MARKET DISTORTIONS AND ALLOWED THOSE ENTITIES TO EXTRACT MONOPOLY RENTS FROM THE INVESTING PUBLIC FOR OVER A GENERATION.

SIGNIFICANTLY, NASDAQ'S ROBERT GREIFELD CANDIDLY ADMITTED AT THE COMMISSION'S REGULATION NMS HEARING ON APRIL 21 THAT THE EXISTING DATA FEES ARE TOO HIGH:

[W]E BELIEVE THE GOVERNMENT SHOULD ONLY BE INVOLVED WHERE THE GOVERNMENT MUST BE INVOLVED. SO WE MUST LIMIT THE MONOPOLY TO THE DATA THAT IS PART OF THE PUBLIC GOOD, AND PROVIDE IT AT A LOW COST . . .

WITH THE CURRENT STRUCTURE . . . DATA IS NOT PROVIDED AT A LOW ENOUGH COST AND IT DOES CREATE . . . UNINTENDED RESULTS AND DISTORTIONS IN OUR MARKET. THE MARKET CENTERS TODAY ARE THE BENEFICIARIES OF THAT EXCESSIVE RENT . . .⁴

IN ADDITION TO QUESTIONS REGARDING WHO OWNS MARKET DATA AND WHO SHARES IN THE REVENUE AND THE SIZE OF DATA FEES, WE BELIEVE THE COMMISSION OUGHT ALSO TO REVISIT HOW MUCH MARKET DATA SHOULD BE MADE AVAILABLE TO INVESTORS. HERE, DECIMALIZATION HAS BEEN THE WATERSHED EVENT. GOING TO DECIMAL TRADING HAS BEEN A BOON TO RETAIL INVESTORS. IT HAS BEEN ACCOMPANIED, HOWEVER, BY DRASTICALLY DIMINISHED DEPTH OF

⁴ Statement by Robert Greifeld, President and CEO of The Nasdaq Stock Market, Inc. at SEC Hearings on Regulation NMS (April 21, 2004), available at <http://www.sec.gov/spotlight/regnms/nmstrans042104.txt> (pp. 223-4).

DISPLAYED AND ACCESSIBLE LIQUIDITY. WITH A HUNDRED PRICE POINTS TO THE DOLLAR, INSTEAD OF EIGHT OR SIXTEEN, THE INFORMATIONAL VALUE AND AVAILABLE LIQUIDITY AT THE BEST BID AND OFFER HAVE DECLINED SUBSTANTIALLY.

PARTICULARLY GIVEN THE EFFECTS OF DECIMALIZATION, ALLOWING THE NYSE, FOR EXAMPLE, TO HOLD MARKET DATA AND LIQUIDITY BACK FOR THE BENEFIT OF ITS FLOOR MEMBERS IS AGAINST THE PUBLIC INTEREST. THE COMMISSION HAS HEARD COMPLAINTS BEFORE ABOUT THE NYSE AUCTION PROCEDURES THAT ALLOW HIDDEN AGENCY AND SPECIALIST ORDERS HELD IN THE CROWD TO HAVE PRICE-TIME PRIORITY OVER ORDERS DISPLAYED VIA THE PUBLIC QUOTATION SYSTEM. THESE FLOOR PROCEDURES GIVE NYSE MEMBERS AN UNFAIR OPPORTUNITY TO JUMP AHEAD OF, OR TO “PENNY”, PUBLICLY DISPLAYED LIMIT ORDERS AND TO “GO ALONG”, OR HITCH A RIDE, ON LARGE INSTITUTIONAL MARKETABLE ORDERS.

IN RESPONSE TO DECIMALIZATION, THE COMMISSION SHOULD RESTORE LOST TRANSPARENCY AND LIQUIDITY BY MANDATING GREATER REAL-TIME DISCLOSURE BY MARKET CENTERS OF LIQUIDITY AT LEAST FIVE CENTS ABOVE AND BELOW THE BEST PRICES. GIVEN THE INCENTIVES OF A SLOW MARKET SUCH AS THE NYSE TO HIDE QUOTATION INFORMATION AND TO BLOCK DIRECT ACCESS TO LIQUIDITY, THE REAL-

TIME DISCLOSURE OF LIQUIDITY SHOULD NOT BE LEFT TO “MARKET FORCES”, WHICH CAN WORK IN THIS INSTANCE ONLY IF DISCLOSURE IS MANDATED. THIS WOULD RESTORE THE TRANSPARENCY AND DIRECT ACCESS INVESTORS HAD BEFORE THE ADVENT OF DECIMALIZATION.

ACCESS FEES. I’D LIKE TO TOUCH BRIEFLY ON ONE OTHER ASPECT OF REGULATION NMS, NAMELY ACCESS FEES. BLOOMBERG HAS LONG BELIEVED THAT ACCESS FEES SHOULD BE ABOLISHED FOR ALL SECURITIES AND ALL MARKETS. WHILE WE APPLAUD THE SEC’S EFFORTS TO REDUCE ACCESS FEES, WE ARE CONCERNED THAT THE COMPLEXITIES INHERENT IN CURTAILING THESE FEES WITHOUT ELIMINATING THEM ARE LIKELY TO CREATE AN UNEVEN PLAYING FIELD.

WE ARE ALSO CONCERNED THAT THE PROPOSED LIMITATIONS ON ACCESS FEES IN REGULATION NMS APPLY ONLY TO THE TOP OF THE FILE. I.E., TO THE BEST BID AND OFFER. WHILE ECNS’ FEES WILL BE LIMITED BY THE AMOUNT PERMITTED UNDER THEIR CURRENT NO-ACTION LETTERS, BY CONTRAST, THE COMMISSION’S ACCESS FEE PROPOSAL DOES NOT APPLY TO ACCESS FEES FOR QUOTES BEYOND THE NBBO.

WE REMAIN CONCERNED THAT THE PROMISE OF DECIMALIZATION WILL BE FRUSTRATED IF THE NYSE IS GRANTED GREATER RIGHTS TO DATA THAT REPRESENTS TRADING INTEREST IN A DECIMALIZED

ENVIRONMENT — IN THE CONTEXT OF MARKET DATA FEES, ACCESS FEES, OR CONTROL OF USES OF INFORMATION — THAN THE NYSE ENJOYED WHEN TRADING INTEREST WAS EXPRESSED IN EIGHTHS AND SIXTEENTHS.

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 21ST 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 21ST CENTURY EQUITY MARKET THAT BEST SERVES INVESTORS.
