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March 9, 2005

**Via Electronic Mail**

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

**Re: SRO Governance and Transparency Release, File S7-39-04; and  
SRO Concept Release, File S7-40-04**

Dear Mr. Katz:

Charles Schwab & Co., Inc., and its affiliates (“Schwab”) appreciate the opportunity to comment on the Securities and Exchange Commission’s (“Commission” or “SEC”) recent proposals reflected in the SRO Governance and Transparency Rulemaking Release<sup>1</sup> and in the SRO Concept Release.<sup>2</sup> Through its affiliates, Schwab engages in a range of financial activities, including retail brokerage, mutual funds, and services to investment advisers and retirement plans. Schwab, a registered bank holding company, controls insured depository institutions through which it engages in retail and private banking as well as trust and fiduciary activities.

Schwab represents the orders of millions of investors executing on multiple markets, and is subject to the oversight of a variety of different regulatory and self-regulatory organizations. The integrity and efficiency of the securities markets are a matter of significant interest to Schwab and its customers. We believe that the Commission must constantly review whether developments in the securities industry are in tune with the existing regulatory scheme. For this reason, we commend the Commission for undertaking a comprehensive examination of the dissonance apparent in the regulation of our securities markets.

While both releases propose a number of significant regulatory changes, we are limiting our comments to certain proposals relating to the organization of SROs, the transparency of their finances and operations, and the governance, pricing and administration of market data fees.

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<sup>1</sup> Securities Exchange Act Release No. 50699 (Nov. 18, 2004), 69 FR 71126 (Dec. 8, 2004).

<sup>2</sup> Securities Exchange Act Release No. 50700 (Nov. 18, 2004), 69 FR 71256 (Dec. 8, 2004).

Schwab supports the Commission's critically important oversight role in ensuring that the operations of SROs are transparent, pro-competitive, and that their rules are applied consistently and fairly - and are not unduly burdensome.

#### Increase Transparency but Leave "S" in SRO

We applaud the Commission's desire to increase transparency through its proposed SRO governance rules – the SROs are unnecessarily opaque to virtually all market participants, from investors to members, even to the Commission itself. Enhanced reporting requirements for SROs will increase the effectiveness of the Commission's oversight and likely reduce the burden on SROs to produce such information during examinations by the Commission. We believe this increased transparency will benefit all market participants by increasing broker-dealer and investor awareness in the strength and breadth of our capital market regulatory programs.

Schwab is concerned, however, that if the SRO rule proposals concerning regulatory independence are adopted as proposed, the element of "self" will be eliminated from "self-regulatory organizations." With little SRO member or shareholder input into SRO regulatory oversight, the Commission appears to be detaching industry knowledge from the regulatory process; in essence, shutting the door on the concept of self-regulation.

We question the need for such a multi-layered regulatory system if the Commission's goal is to obtain greater responsiveness from the SROs. The Commission already directly regulates each SRO and has broad power under current law to impose strict requirements over virtually every aspect of SRO governance. Divorcing industry participation from SRO regulatory oversight does not enhance the Commission's plenary authority but, rather, weakens the ability of SROs to apply the "just and equitable principles of trade" that stem from the highest ethics of market participants. Member participation brings with it a practitioner's knowledge of the industry and historically has made the regulatory and enforcement process pragmatic and efficient. This fundamental principle must be retained if we are to consider the structure "self-regulation." As an alternative to the complete independence of regulatory and other Standing Committees within SROs, Schwab suggests that membership of SRO standing committees, including the committee charged with regulatory oversight, be composed of a majority of independent directors with positions reserved, however, for member directors.

#### Without "Self" Regulation, Direct Regulation

If the Commission intends to eliminate self-regulation, then we believe that the SEC should instead assume responsibility for all regulatory oversight, thereby eliminating redundant regulatory obligations and enhancing the cost effectiveness of the regulatory scheme. Already, there exists a model for this kind of direct regulation: the banking industry is of course a very complex one, but its regulation is effectively managed by the Federal Reserve Board.

Moreover, we also believe that confining the discussion simply to the SROs is unnecessarily limiting. Broker-dealers such as Schwab are also regulated, on many of the same issues, by banking regulators, state regulators, and international regulators. Many of our global competitors have consolidated regulatory regimes, and the Commission should be mindful of the international competitive pressures that domestic financial institutions face in that regard. Any

discussion of improving the efficiency, transparency and overall effectiveness of the regulatory system ought to take into consideration how to improve coordination and cooperation across the entire regulatory spectrum.

### Universal Self-Regulator is the Best Regulatory Approach

If the Commission intends to maintain the self-regulatory system, Schwab urges the Commission to consider unifying the SRO structure to achieve more effective and streamlined regulation. Schwab supports the creation of a Universal Industry Self-Regulator that would retain significant industry participation in its oversight role.

In our view, the greatest single flaw in the current structure is that it produces both duplication and divergence. On the one hand, companies are required all too frequently to perform the same task or provide the same information to multiple regulators. On the other hand, companies are required equally often to follow needlessly different requirements among the different regulators for the same set of issues. Regulatory reform should alleviate these concerns. By tying industry knowledge to a comprehensive, efficient single regulator, we believe the Commission can promote regulatory reform that truly is in the best interests of public investors.

Although the Commission has suggested a number of alternative regulatory structures that might improve the current regulatory structure, a structure that optimally enhances market quality and reduces the economic burden on market participants is, in our view, the correct choice. We have advocated on a number of occasions that the creation or designation of a single, independent self-regulator for the securities markets, including the options markets, would provide a much more consistent approach to regulation, surveillance and examinations across all markets and securities than exists today. In light of the alternatives proposed, it continues to be our view that a Universal Industry Self-Regulator would be best suited to modernize the SRO structure. This structure is most likely to minimize conflicts of interest and reduce unnecessary regulatory costs.

Over the years, Schwab has been regulated by multiple SROs based on the markets in which we operated. Moreover, even though we may have one designated examining authority for a particular affiliate, there has always been significant regulatory overlap, creating unnecessary expenses that are ultimately passed along to investors. These redundancies can produce millions of dollars of expense per firm on an annual basis, with little or no benefit to investors.

We also believe that levels of investor protection vary from market to market based on the quality of their surveillance programs and the vitality with which they enforce their rules. We also have witnessed on numerous occasions the conflicts of interest described in the SRO Concept Release. These conflicts have been particularly evident when markets are dominated by a few members, or the markets compete with their members for order flow. In addition, the fact that the markets themselves compete with one another - and that the regulatory function is ultimately supported by the amount of business each market attracts - creates an inherent level of conflict.

Unlike the proposal to segregate regulation from operations within an SRO, a single Universal Industry Self-Regulator would substantially eliminate the conflict of interest concern. Because

its funding and operations would not be captured by a single market center, competition among markets may occur without jeopardizing the regulatory integrity of any particular market.

Moreover, the independence inherent in this approach would offer substantial improvements to the existing regulatory structure. Among other things, we believe that the consistency and quality of regulatory oversight among markets would increase. Cross-market surveillance and oversight would be significantly improved. In addition, we would expect substantial cost savings in terms of reduced operating expenses for the SRO, as well as a reduction in expenses among member firms that result from consolidation of examinations rather than half-hearted attempts to coordinate them. Finally, a single self-regulatory authority would eliminate the need for each SRO to appoint a Chief Regulatory Officer and the concerns expressed by the Commission about reporting within SROs, because all regulatory officers and staff members would report solely to the single self-regulator.

We want to caution, however, that it is critical in our view that a Universal Industry Self-Regulator retain the active involvement and contribution of industry members. Schwab urges the Commission to reconsider its proposal to completely separate the industry from the Regulatory Oversight Committee or whatever body is ultimately responsible for regulation. Member or shareholder participation on committees that consider governance, rulemaking, disciplinary and funding-related issues must be a part of any SRO system. Without such industry participation in regulatory oversight, we would prefer that the Commission terminate the SRO structure entirely and assume the direct regulatory responsibilities of the SROs.

#### NASD As a Possible Location for Universal Self-Regulator

In our view, the National Association of Securities Dealers (“NASD”) is, among current regulators, a logical candidate for a leadership role in a consolidated self-regulatory structure. Its historic scope, independent structure, and record of being the most cost-efficient regulator should result in the least disruption to the markets. As we have noted in the past, the NASD has done more at this point than most other markets to separate its regulatory function from the competitive market function.

Moreover, we believe that additional changes discussed by the Commission that enhance transparency and modify the organization structure could further its independence. The NASD has served as the primary regulator of broker-dealers since its inception, improving its technology and personnel infrastructure to meet the changes in the industry. It also has regulated both OTC and listed equities in the third market, along with OTC options. Thus, we believe that it has a solid foundation from which to regulate all securities. While less directly involved in the regulation of exchange-traded equities and options, building out its infrastructure, while maintaining the expertise of the current self-regulatory staffs of different market centers, would be an efficient way to proceed.

#### Market Data

Finally, we again comment on elements of the current market data controversy. As we have shared with the Commission on multiple occasions, we believe that an entirely new regulatory

approach is necessary to address the capture and sale of market data. The basic elements that we feel are necessary to modernize the current system include:

- fees based on the costs of consolidation, storage, transmission and other data processing and administrative costs as established through an independent accounting;
- public participation in the governance of the cartels;
- simple uniform contracts and rules that minimize administrative burdens; and
- inclusion of additional information on market depth in the consolidated quote stream to increase market data quality so that retail investors are not disadvantaged.

With regard to the proper level of fee assessment, as we have noted earlier, we disagree strongly with any notion that fees from the sale of market data should support regulatory functions. Schwab strongly supports well-funded regulation yet does not believe that market data revenue should subsidize SROs regulatory or other funding needs. Moreover, as we have seen in the recent past, market centers use market data revenue to subsidize competition with other market centers. We believe it is high time to change this misguided structure.

While some have argued that there is a correlation between the integrity of the market data and the regulatory structure, we think that this argument is a red herring. Violative activity certainly operates to the disadvantage of investors, but does not corrupt the market data that results. Trade prices and volumes are what they are and should be disseminated to the public. The fees associated with that dissemination should reflect only the costs of producing the data, not the costs associated with regulating trading behavior. To avoid the risk that market data revenues are redirected to inappropriate purposes, markets should fund vigorous regulatory programs through fees charged to the users of such markets.

With respect to the administrative burden attached to the Network Plans, Schwab has long advocated for immediate and substantial change. The entire process is needlessly complex and must be simplified. There should be a uniform Network Plan contract that contains uniform definitions of fee categories, uniform access, and a uniform system of billing and collection to reduce the inconsistencies across SROs. We respectfully encourage the Commission to require such uniformity. By reducing the significant hidden costs of administering market data systems currently imposed on broker-dealers, the Commission would be improving market data operations for the benefit of all market participants.

Quality of market data has become the most troubling concern because of the decrease in transparency as a result of decimalization. Consequently, investors need more data to maintain a comparable level of visibility in the marketplace. Thus, the basic market data that is available to many investors today is insufficient; and it is now critical that investors have the ability to see price and volume away from the inside quote. We believe that Network Plans should be amended, as the Nasdaq UTP Plan has already been amended, to permit Securities Information

Processors to disseminate full depth-of-book information as a core product. By requiring the Network Plans and their processors to provide investor access to real-time depth-of-market information at a cost that is reasonably related to the cost of providing such data and on terms that make such data reasonably accessible to individual investors, the Commission would benefit the entire investing public.

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Thank you for the opportunity to share our views on these issues of critical importance to our markets and to investors.

Sincerely,

Jeffrey T. Brown

cc: The Hon. William H. Donaldson, Chairman  
The Hon. Paul S. Atkins, Commissioner  
The Hon. Roel C. Campos, Commissioner  
The Hon. Cynthia A. Glassman, Commissioner  
The Hon. Harvey J. Goldschmid, Commissioner  
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