

Intermarket Surveillance Group

March 8, 2005

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

RE: File No. S7-40-04; Self-Regulatory Organizations

Dear Mr. Katz:

I am writing on behalf of the Intermarket Surveillance Group (“ISG”), which appreciates the opportunity to comment on the Commission’s concept release on self-regulation (“Concept Release”).¹ The Concept Release discusses a number of important aspects of the U.S. regulatory structure and whether the current self-regulatory approach continues to be adequate in our changing environment.

In particular, Questions 14, 15 and 16 of the Concept Release seek comment on the effectiveness of the ISG in serving as a facilitator of regulatory sharing and surveillance coordination among the multiple U.S. securities markets that are self-regulatory organizations (“SROs”), and whether greater consolidation of surveillance information across the SROs is necessary. As discussed below, the ISG is an effective facilitator of cooperative regulation and is addressing the issues the Commission has raised with respect to consolidated surveillance information.

¹ ISG’s full members are the American Stock Exchange (“AMEX”), Boston Stock Exchange (“BSE”), Chicago Board Options Exchange (“CBOE”), Chicago Stock Exchange (“CHX”), National Stock Exchange (“NSX”), International Securities Exchange (“ISE”), National Association of Securities Dealers (“NASD” – which is the SRO serving as NASDAQ’s regulator), New York Stock Exchange (“NYSE”), Pacific Exchange (“PCX”) and the Philadelphia Stock Exchange (“PHLX”) (collectively “Full Members”). The PCX did not concur with the submission of this letter because it believes it is not appropriate for ISG as such to submit a comment letter when, as here, the individual ISG members can, if they choose, submit their own comments. Each of the Full Members is an SRO for which the Commission has direct oversight. In addition to the SROs, the ISG has 20 affiliate members from around the world, representing both securities and futures markets.

ISG's Role and Effectiveness

The goal of ISG is to enhance intermarket surveillance, to assure the integrity of trading and to provide investor protection. As its primary functions, ISG coordinates surveillance and investigations among its members in and across a diverse population of securities products including equities, options and futures in the United States and internationally. In this regard, ISG has established information sharing arrangements that provide for the exchange of market data surveillance information among its members through various means. In connection with the routine sharing of information, ISG has also defined certain types of violations that can occur across markets and the SROs have consistently worked together to coordinate regulatory responsibilities.

Through ISG, the SROs share audit trail information on a routine basis. ISG has developed and implemented investigative practices for coordinated investigations. Further it has established a sub-group on surveillance practices to supplement the existing ISG sub-groups. ISG's general meetings, held three times each year, as well as frequent meetings of the Surveillance Practices, Surveillance Investigative Practices, Technology, and Option sub-groups, have resulted in more uniform definitions of intermarket abuses and have provided a forum for coordinating joint surveillance efforts. The SROs believe that their surveillance programs are enhanced through participation in these sub-groups. Additionally, Commission staff from the Office of Compliance Inspections and Examinations ("OCIE") and the Division of Enforcement regularly attend ISG meetings and work closely with the SROs on surveillance-related matters through ISG sub-groups.

While the SROs are responsible for their own surveillance systems to monitor for violative activity, they have worked together through ISG to create many surveillance tools to supplement their own programs, including the ISG Consolidated Equity Audit Trail ("Equity Audit Trail"), Electronic Blue Sheet facility ("EBS") and the Unusual Activity File ("UAF"). To the extent there are costs involved with the development and maintenance of these surveillance tools and the operation of ISG generally, the SROs have mutually agreed on the allocation of these costs.

Thus, the SROs believe that ISG has been effective in enhancing surveillance of the U.S. securities markets, and that it provides an important forum within which the SROs can further develop and improve intermarket regulation, both domestically and internationally.

Consolidation of Data Bases

The SROs agree that consolidated audit trail information is essential to effective intermarket trading surveillance. The Equity Audit Trail was developed by the SROs to provide a consolidated view across all U.S. equity markets of quotes and trades and clearing information for each of these trades. At its most recent meeting on February 25, 2005, the ISG agreed to form a new Consolidated Data Bases Sub-Group. The intent of this sub-group is to explore the ways in which the current SRO data bases might be expanded and leveraged, as well as to consider whether a uniform approach across equity SROs, similar to that taken

by the U.S. options exchanges with respect to the Consolidated Options Audit Trail System (“COATS”), is beneficial and feasible. This sub-group will include representatives from the equities exchanges, NASD and options exchanges, so that opportunities to coordinate the two ISG audit trails and other SRO data bases such as the NASD’s Order Audit Trail System (“OATS”), the NYSE’s Order Tracking System (“OTS”) and the NSX’s Firm Order Submission File (“FOS”) can be explored. Finally, this sub-group will explore the potential benefits and feasibility of integrating information from the U.S. futures markets with that from the securities markets.

The SROs believe that creating the existing technology infrastructure for consolidated audit trail information through the ISG has enhanced intermarket trading surveillance for securities. Further enhancement to that infrastructure could provide potential future opportunities for more efficient and effective surveillance across different domestic and foreign markets. As we have seen with the development and implementation of COATS in the U.S. options markets, further consolidation of detailed surveillance information is achievable, but is a hugely complicated effort that requires careful design. Accordingly, we believe that the ISG is well suited to address the issues the Commission raised in this respect.

Conclusion

The ISG has served as an effective forum for the development of intermarket surveillance tools and regulatory information sharing. As the U.S. securities markets continue to evolve, we believe it will become increasingly important for ISG to facilitate cooperative regulation among the SROs, as well as globally among different types of financial markets. We look forward to working closely with the Commission to achieve this goal.

If you have any questions related to this letter, you may contact me at (212) 897-0233.

Sincerely,

Katherine Simmons
Chairman
Intermarket Surveillance Group

Enclosures

cc: Chairman William Donaldson
Commissioner Paul Atkins
Commissioner Roel Campos
Commissioner Cynthia Glassman
Commissioner Harvey Goldschmid
ISG Members