

JAMES K. RUTLEDGE  
176 East 77<sup>th</sup> Street  
New York, New York 10021  
Rsg256@aol.com  
212.734.0934

**SECURITIES AND EXCHANGE COMMISSION**  
**PROPOSED REGULATION NMS**  
**Release No. 34-49325**  
**FILE NO. S7-10-04**

**Comment Submission**

**June 29, 2004**

Amended June 30, 2004

Rutledge

## TABLE OF CONTENTS

Page Number	Subject
1	I. Introduction
2	II. Foundation, Objectives, Merits and Caution Defining Investors & Responses A. The Investor B. Responsibilities
3	III. The Benefits of Extension A. Overview B. Specific to Author IV. Determining Relativity V. The Approach
4	VI. Interpreted Discovery? A. Mar. 01, 1999 Feb. 24, 2004 Feb. 26, 2004
5.....	B. Oct. 17, 2002 C. Apr. 26, 2004
6	D. Apr. 27, 2004
7	VII. The Unrestrained and The Subtle Influence A. Europe's Template B. Market's Backbone 1. Electronic 2. Auction 3. Integrated Hybrid
8.....	
9	VIII. Disclosure Concern IX. Conclusions X. Disclaimer and Acknowledgment

James Rutledge  
New York, New York

Mr. Jonathan G. Katz  
Secretary  
Securities and Exchange Commission  
450 Fifth Street, NW  
Washington, DC 20549-0609

**PROPOSED REGULATION  
NMS  
RELEASE NO. 34-49325  
FILE NO. S7-10-04**

Securities and Exchange Commission Mission Statement:

The primary mission of the US Securities and Exchange Commission is to protect investors and maintain the integrity of the securities industry.

June 29, 2004

Dear Mr. Katz:

I. Introduction

Participating in a process shaping the future of securities markets, having the opportunity to comment on proposed Regulation NMS and supplementary releases, is a privilege that demands suppression of self interest along with a responsibility to evaluate all the offerings and arguments on their merits, with a primary focus on the *"greater good of investors"*.

The Commission's initial encouragement for public comment has permitted a range of responses, one would assume, from a variety of interested parties. As an individual and independent respondent and in view of the importance of the subject matters, where my reference resources are limited, my scope will be measured.

My lengthy professional experience (over thirty years, primarily on the trading floor of the NYSE) will no doubt persuade my opinions, vision, conclusions, etc. Please be assured though, I recognize that you/we have defining choices and decisions to be made which will serve as a watershed event that will contribute important framing to US equity markets. Our collective goal must be insuring our markets remain the envy of the world and will serve as our legacy.

Furthering my personal transparency, as mentioned, I have served as an agent on the trading floor for most of my career (though currently inactive), primarily in the institutional sector. I own Memberships on the NYSE and Boston Stock Exchange (BSE) and hold a European trading permit on the NYBOT in the foreign currency trading space.

1.

## II. Foundation, Objectives, Merits of Change and Caution

The Published release of proposals, including the redesign of the existing national market system (“NMS”) rules, would be adopted under Section 11A of the Securities Act of 1934. The stated objectives of Regulation NMS as set forth in the Exchange Act, along with proposals for uniform rules governing all NMS market centers can be summarized as: efficiency, competition, price transparency, best execution, and direct interaction of investor orders. *The objectives are indeed worthy; the challenges lie within futuristic framing and the need to maintain balance.*

It has been said that innovation and actionable information are the currency of business, but from a conservative’s perspective a better course can be encapsulated in a favorite witticism that a distinguished senior member of the House often refers to and might serve all interested parties to consider: The 18<sup>th</sup> century British statesman Sir Edmund Burke’s frequent admonition was: *“refrain from change for changes’ sake”,* simply put, *“if it ain’t broke, don’t fix it”.*

This is not to ignore the continuous need for self-examination that will insure global competitive vitality. Affirmative change has been the hallmark of US capital markets. Determining the value of any change must include risk evaluation, set to sound an alert for deleterious effects. Any compromise of market confidence would imperil our capital markets as the world’s “gold standard” and is not an option. The protection of investors must remain paramount and despite their protestations, the affected professional will be forced to acquiesce.

## III. Defining-Investors & Responsibilities

### A. *The Investor: \in-ves-ter\ (n)*

1. *One who commits (money) to earn financial gain. Commits or furnishes power and authority in return for advantageous benefits.*
2. *One who invest in the integrity of people and the markets. Who expect complete transparency, particularly from their (fiduciaries) and that they can be assured of the best available price.*  
*\* Author’s version*

### B. Responsibilities

The responsibilities at hand are overwhelming but I am confident the Commission, along with all who accept the label of leadership, will navigate the challenges that will help to define the future market center. Our goals should be clear: innovation, trading cost efficiencies, market integrity, reliability, flexibility, etc., focused on the investor.

2.

### III. The Benefits of Extension

#### A. Overview

I am grateful, and suspect many would agree, for the Commission's patience and vision in granting an extension to the comment period. The additional time has allowed clarification of the commonality and bifurcation between: investors, issuers, practitioners, regulators and legislators, and within the commission, etc. The further defining of perspectives, priorities, intended goals and visions for the future can only enhance the deliberations and help to have constructive influence on the resulting courses of action.

#### B. Specific to Author

Personally, prior to the extension and due in part to the broad scope of topics coupled with the limitations inherent to an independent respondent, establishing how best to contribute to the process became a difficult and exhausting exercise, but I was determined in my efforts.

Initially, I employed a methodical approach. An insatiable pursuit for enlightening information began with volumes of statistical comparisons, much of which later proved to be anecdotal. Adding to my "research vault": white papers from self-appointed market structure experts, venue position papers, previously prepared statements for presentation to whoever would listen and even the Commission's supplemental offering etc., which all became overwhelming.

### IV. Determining Relativity

A coordinated undertaking and the resources to support it, both economic and human, provides a textbook example of the advantages of size when disproportionate to others. Effective representation of one's position, penetration of a wider audience, reinforcement of a strategic alliance, uncovering a sympathetic ear or persuading the undecided, are directly budget related. Interestingly those resources do not necessarily equate with: quality, reliability, objectivity, or not unexpectedly, confidence.

Accordingly, I have chosen a more pragmatic approach, suppressing an ingrained bias towards the traditional. You will no doubt find my subject interpretation eclectic and the presentation contemporary.

### V. The Approach

Unearthing uncommon information can expose forgotten, ignored or otherwise under appreciated treasures which, *when put in context*, can prove significant. Current opinions, priorities, benchmarks, etc. might prove to be a contradiction to the past. Indications of past persuasions or previously undisclosed or under exposed alliances, investments, etc., can provide valuable guidance tracing the source(s) of current motivations. Information that is not proprietary can still be a treasure when approached from a different viewpoint.

Wrapped around the eclectic has been my more traditional methodology, such as attending numerous Commission hearings tracing back to November 12, 2002, through the most recent on April 21, 2004 as well as many of the legislative hearings, held both in New York and Washington and both proved to be enlightening . Participation in industry sponsored market structure conferences, also in the east coast money centers have been useful. Throughout this document you will find narratives, observations conclusions and opinions often influenced by these experiences.

## VI. Interpreted Discovery?

- A. March 01, 1999-  
Wall Street Journal-by Greg Ipp  
*Interview with Large Mid-West institutional investor*  
Manager of Domestic Trading

Responding to the question of the possible entry of the NYSE into trading of NASDAQ stocks, the response was: "the introduction of some of the rules governing the Big Board trading would make the NASDAQ even better, such as the *trade through rule* that can explicitly penalize a dealer for executing an order at a price that is inferior to one in another market".

February 24, 2004-  
Wall Street Journal  
*Interview with The same Large Mid-West Institutional investor*  
Chief investment Officer

Commented on how fast markets should bypass a better price on a slow, non-automated market, as long as the investor gets a price within 1 to 5 cents of the best available price.

February 26, 2004  
Business Week Online  
*The same large Mid-West Institutional Investor*  
Chief Investment Officer

Commenting on the merits of changing or eliminating "best price" to accommodate "fast markets", suggested these rule changes will go a long way toward making some traditional market venues, if they don't adapt, die.

**"In my view"**- *Evidently, in less than five years, this institution has gone from praising the trade through rule and citing how the rule would specifically penalize a dealer for executing an order at a price that is inferior to one in another market, to supporting a contradicting position that fast markets should bypass better prices on a slow, non-automated market, as long as it is within certain price parameters.*

- B. October 17, 2002  
Washington, D.C.  
House Energy & Commerce Sub-Committee on  
Market Structure (Early in the discussion process)  
Opening remarks, senior sub-committee member.

"Floor trading could be done more efficiently by computers". He went on to state the primary reason for the hearing was to learn how ECNs could play a more prominent role in the equities market.

This same legislator commented that he did not know: "Why does trading have to occur in a certain time frame?"

There were also a handful of security industry representatives in attendance, four from different ATS's who echoed their belief that *fragmentation is not a negative, but rather it is competitive.*

When asked by the same legislative if customers are "paying too much for market information", a senior representative of a popular ATS argued "it is appropriate to charge for a service or a product provided to a customer".

*"In my view"- Legislators are the target of influences that are often represented by highly skilled lobbyist. Issuers, investors, practitioners, institutions, etc. are no strangers to the process, and are no strangers to the risks and rewards of their efforts. However the process can be compromised when indications (real or imagined) indicate the results are predetermined. This becomes a source of inflamed frustration, particularly if the conclusions appear to be the result of "stove-pipe" vision, eviscerating opposing positions.*

- C. April 26, 2004-  
Washington, DC  
Trade Organization-

An organization of financial service industry professionals; includes Senior executives, managers of money, intermediaries, representatives of major stock exchanges. Group's common objective: analysis of current Influences and supporting a favorable regulatory environment.

Meeting focus-Regulation NMS. There was no attendee consensus and uncharacteristic "straw visions" apparently influenced specific agendas. Of course "informed" opinions were abundant. The organization, guided in part by attorneys, *did produce* a worthwhile report: The specifics of Regulation NMS proposals, analysis of merit, implications if adopted, etc.

5.

Some trade report highlights:

Reg. NMS

1. Proposed trade through rules appear, until further Clarification, have little justification.
2. The proposed rule would permit executions at inferior prices on automated execution facilities.
3. Disturbing questions of rule proposal "top-of-book quoting" feasibility.

Rule 610

1. After-the-fact access fees for transactions against their quotes is inconsistent with an efficient market and represents economic burden.
2. Substantial doubt whether SEC has the authority to set access fees, per Securities Exchange Act of 1934

*"In my View" This organization is an untapped resource when seeking diverse opinions from experienced, well qualified professionals. Occasionally, the offerings lose value due to the conflicted, self-interest incentives.*

- D. April 27, 2004  
Washington, D.C.  
Annual Government Conference  
Sponsored by a National Securities Trade Group  
Title Subject-Market Structure  
Participants included-Legislators, Regulators & Ind. Professionals

Q&A after panel discussions and legislative presentations

1. Legislator #1 declares support for "trade through" elimination and "opt-out".

*Audience question to same Legislator.-"Are you worried about internalization if trade through is eliminated".*

Legislator #1's answer-"I am well versed on most of the issues, but this one is a difficult subject to understand and if I don't grasp it, there is virtually no chance my colleagues will understand".

2. Question by me to Senior Legislator #2-"If opt-out proposal is adopted and speed versus best price is chosen, will fiduciaries be afforded safe harbor in the event there is a shareholder action brought?"

6.

Senior legislator #2 responded: "I don't know if this is a legislative issue or a regulatory issue".

*"In my view" - Consider these individuals represent some who have an influence on critical issues which will define the United States capital markets. They appear to be unprepared ,unqualified, disengaged and cause for alarm!*

## VII. The Unrestrained and The Subtle Influence

### A. Europe's Template-

Europe's History of trading pre-dates the U.S. by centuries, yet our markets and economy quickly assumed a position of leadership thanks to the vision of our for-fathers like Alexander Hamilton and the twenty four merchants beneath a Wall Street tree.

In 1986, Europe's FSA directed "Big Bang", leading to the introduction of an all electronic market, and the resulting end to floor based trading.

In analysis, has this lead to:

- Global marginalization
- Reduced pricing integrity
- Reduced Price & Liquidity discovery
- Comparative volume reduction

Fortunately, despite recent domestic corporate "difficulties" and the resulting legislative initiatives, cross border issuers continue to come to the US Capital markets. (Further discussion later)

### B. Market's Backbone, a Micro Server vs. Human representative.

#### 1. Electronic Market

##### A. Advantages

1. Speed
2. Potential for recapturing Transaction Expenses- equity interest in facility

##### B. Disadvantages

1. Investor confidence in best price
2. In evolving hybrid environment no longer have speed advantage
3. Dearth of Liquidity- primary source requires access to others.
4. Passive, Order Driven Market- There are no stimulants or affirmative responsibility to mitigate price dislocation.
5. Fragmentation and Enabling internalization

7.

## 2. Auction Markets-

### A. Advantages

1. Best price assurance
2. Integrating speed with price discovery.
3. Central market enhances: price discovery, liquidity, transactional integrity.
4. Equal Representation
5. Continuity and reduced price dislocation due required dealer obligations.
6. Personal service vs. inanimate micro service.

### B. Disadvantages

1. Position as SRO position builds friction with users (buy & sell side) that prioritize internal considerations versus fiduciary responsibilities.
2. Price discovery sometimes interferes with predetermined pricing.
3. Requires best price, no diminimus exceptions to facilitate internal strategies.

## 3. Integrated (Hybrid) Markets- Technology & Human Intermediary

### A. Advantages-

1. Allows benefits of discovery and speed of implementation.
2. Potential Efficiencies of cost.
3. Connectivity-can lead to better alternate facility representation
4. Constantly evolving.

### B. Disadvantages

1. Potential for practitioners versus investors gaining advantage.
2. Personal responsibility reduced.
3. Intuitive advantage reduced.

## VIII. Disclosure Concern

It is difficult to be confident that contributed opinions are unconflicted, particularly when disclosure is either not available or easily attainable. Equity ownership or strategic alliances can be the keystone that would explain support of non-traditional facilities or trading strategies that ignore price.

Unconcealed ownership of the traditional facility, as example the NYSE, BSE, CSE, NASDAQ, etc., mutualized or publicly owned, leaves little question as to ownership and responsibility.

## IX. Conclusions

The supporters for modifications or eliminations, many the bedrock of our markets, hope they can harness *traction* for their positions but must use caution where they *tread*.

The world landscape is evolving and due to a number of influences, our *global positioning* is under attack. Disclosures of corporate indiscretions and the resulting legislative and accounting restrictions have dampened cross-border harmony. Changes that may cause uncertainty in our markets framework might add to our position deterioration.

The United States securities markets are a national treasure and must be protected at all cost. All investors, domestic and cross-border, are fortunate to have the Commission as our "first line of defense" and can have confidence those responsible will sift through the "noise" and draw the conclusions that serve the markets and the country well.

It is my sincere hope this submission is a positive contribution. I must remind I assume sole responsibility for the content. Names and other specifics not thought to be pertinent or prove to embarrass, have been omitted, but can be available upon Commission requests.

I remain available to discuss any point with the Commission and willing to conference in Washington or by telephone.

Thank You,

James K. Rutledge  
176 East 77<sup>th</sup> Street  
New York, New York 10021  
212.734.0934 Mob. 917.520. 4737  
rsg256@aol.com

END

9.

