



February 2, 2005

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

Re: File No. S7-10-04 – Regulation NMS

Dear Mr. Katz:

The Operating Committee of the Nasdaq Unlisted Trading Privileges Plan (the “UTP Plan”)¹ respectfully provides the Securities and Exchange Commission (the “Commission”) with its views regarding two specific aspects of repropoed Regulation NMS.² The Operating Committee commends the Commission and its staff for their continued efforts to address the effects of significant technological and economic change on the nation’s securities markets.

In general, market structure regulation works best when it simultaneously protects investors and preserves flexibility for markets and their participants. In this regard, the Operating Committee would like to comment on two aspects of repropoed Regulation NMS that would require amendments to the UTP Plan that the Operating Committee believes are overly rigid. Specifically, the Operating Committee would like to comment on: (i) the detailed provisions regarding the NMS Plan Advisory Committees; and (ii) the formalization of an annual payment mechanism for the allocation of market data revenues collected by the UTP Plan that would prevent NMS Plans from adopting an alternative payment mechanism. With respect to both proposals, the Operating Committee believes

¹ The UTP Plan is currently composed of the American Stock Exchange, the Boston Stock Exchange, the Chicago Stock Exchange, NASD, the National Stock Exchange, the Pacific Exchange, and the Philadelphia Stock Exchange. All participants have representation on the Operating Committee. The views of the Operating Committee expressed in this letter represent the views of the individual SRO staff members and may not have necessarily been reviewed or endorsed by each SRO’s Board.

² Exchange Act Release No. 50870 (December 16, 2004), 69 FR 77424 (December 27, 2004) (the “Repropoing Release”). Regulation NMS was originally published for comment in February 2004 with a supplement issued in May 2004. See Exchange Act Release No. 49325 (February 26, 2004), 69 FR 11126 (March 9, 2004), Exchange Act Release No. 49749 (May 20, 2004), 69 FR 30142 (May 26, 2004). Importantly, while the scope of this letter is limited to two aspects of repropoed Regulation NMS, each participating SRO may be submitting a separate, independent comment letter to the SEC regarding other provisions of repropoed Regulation NMS.

that greater UTP Plan flexibility would achieve the Commission's intended purposes in a more productive and efficient manner.

The Governance Amendment

As drafted, repropoed Regulation NMS would require the UTP Plan and other market data plans to adopt an amendment (the "Governance Amendment") that would require the establishment of a non-voting advisory committee with the right to submit its views regarding plan matters. The Governance Amendment includes detailed provisions regarding the composition of each such committee, the length of committee member terms, functions and rights of access to plan meetings and information.³

The UTP Plan recognizes that an advisory committee can play an important role in effective plan governance and has taken a leadership role in this regard. In fact, the Operating Committee amended the UTP Plan to establish a UTP Advisory Committee in 2002.⁴ The UTP Advisory Committee was established with broad representation among vendors, brokers and investors. Composed of knowledgeable, committed members, the UTP Advisory Committee held its first meeting with the Operating Committee in September 2004 and set an agenda of issues for the Operating Committee, which are being addressed.

The Operating Committee would like the chance for the work of this body to continue, without the dislocation and disruption the Governance Amendment may unintentionally cause. At a minimum, the Governance Amendment would require re-constitution of the UTP Advisory Committee, in order to comply with the composition requirements. At worst, the Governance Amendment could lead to a significant decline in the efficacy of both the UTP Advisory Committee and the UTP Operating Committee, as the ability of the Operating Committee to govern the plan quickly and efficiently may be impaired.

As an alternative, the Operating Committee suggests the following text for a Governance Amendment:

- (a) Notwithstanding any other provision of this Plan, an Advisory Committee to the Plan shall be formed and operate for the purpose of providing transparency into and input regarding the operation of the Plan for broker-dealers, vendors, and retail and institutional investors.

³ 69 FR 77497.

⁴ This plan amendment was filed with the Commission and published for notice and comment in the *Federal Register*. The Commission approved the amendment to the Plan as consistent with the Securities Exchange Act of 1934. See Exchange Act Release No. 46729 (October 25, 2002), 67 FR 66685 (November 1, 2002).

- (b) Rules regarding the composition and functions of the Advisory Committee shall be established and filed with the Commission pursuant to the filing requirements of the Plan itself.

This approach would achieve the Commission's objective of broader participation in Plan governance, but in a manner that allows for each Plan to create a framework that works well for its particular circumstances, subject to Commission oversight.

The Formula Amendment – Annual Payment Provision

In its proposed amendment (the "Formula Amendment") dictating broader changes for how market-data plan revenue is allocated among participants, repropose Regulation NMS would require plans to distribute "an annual payment for each calendar year" based on a proposed formula calculation.⁵ Acknowledging the current practice utilized by the UTP Plan and other plans to make estimated quarterly payments in advance of an annual calculation, the Commission states this provision "merely tracks existing Plan language" and that "[n]othing in the repropose formula prohibits Networks from making estimated quarterly payments."⁶

Some Participants of the Operating Committee believe that the current process of annual payments made via quarterly estimations should be reconsidered. Given the dynamic state of market activity and competition, intra-year changes in market data revenues, market volumes, and Plan participant market share may create the potential for large disparities between the quarterly estimated and annual actual payments. The proposed allocation formula changes introduce new variables into the calculation (such as quoting activity) that could intensify this possibility.

To address this, the Operating Committee is currently considering a UTP Plan amendment that would require the Administrator to issue payments on a quarterly basis, rather than on an annual basis.⁷ This would provide UTP Plan participants with revenue on a schedule consistent with their reporting obligations. In order to preserve individual Plan autonomy and flexibility to introduce such changes, the Operating Committee suggests alternative language for the relevant section of the Formula Amendment (with proposed replacement language underlined):

- (a) Notwithstanding any other provision of this Plan, each Participant eligible to receive distributable net income under the Plan shall receive a payment for each payment period (such period being established by the Operating Committee)....

⁵ 69FR 77497.

⁶ *Id.*, at 77467 n. 343.

⁷ The audit of Plan financials would continue to verify the accuracy of the quarterly payments.

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Such language allows each plan to provide a payment timeframe that meets the needs of its participant and the particular UTP Plan.

Conclusion

Striking the right balance between regulation and competition will be the key to the success of the reforms of proposed Regulation NMS, both in broad approach and with respect to detail. The Operating Committee appreciates the opportunity to offer its input. Should you have any questions regarding this letter, please do not hesitate to contact me at (312) 442-7975, and I will arrange to have you speak with the UTP Operating Committee on these matters.

Sincerely yours,



Bridget M. Farrell
Co-Chairman
OTC/UTP Operating Committee



Michael P. Rountree
Co-Chairman
OTC/UTP Operating Committee

cc: William H. Donaldson, Chairman
Paul S. Atkins, Commissioner
Roel C. Campos, Commissioner
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