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OFFICE OF THE SECRETARY

The Honorable William H. Donaldson
Chairman
S.E.C.
450 Fifth St. N.W. Room 6100
Washington, D.C. 20549-0609

12/24/04

Re:File No. S7-10-04 Proposed Rule on Regulation NMS

Dear Chairman,

I am writing to express my concerns about the S.E.C.'s proposed Regulation NMS. One of the options that might be choosen-creating a CLOB (Consolidated limit order book) would radically change the structure of our U.S. Stock markets.
The New York Stock Exchange is on the verge of implimenting a hybrid market that would allow for limited human intervention. This CLOB would eliminate the opportunity for a negotiated trade within the system, hurting the public's interest and would preclude any possibility that this new hybrid system will become operational.
As a constituent and a Member of the New York Stock Exchange I urge you to express your support for the NMS proposal without the CLOB provision to the other Commissioners.

Sincerely,

Peter J. Frank

SEC PROPOSAL ON REG NMS

Summary: The SEC has put on the table two proposals for our national equities market structure going forward; one of these provides investors with best price protection while still leaving markets with adequate incentives to innovate and compete. The other, which entails attempting to route orders to any displayed quote in any market center, would effectively turn U.S. equity markets into a government utility. This is a radical proposal which would replace internationally competitive, investor-driven markets with a government mandated one-size-fits-all system.

Best price is the result of quote competition combined with inter-market competition: Protecting the best price in every market gives investors confidence that if they take the risk to be the best bid or offer, they will not be "traded through." As a result, investors compete within markets to be the best, spreads are tight, and costs are low. This order competition is complemented by competition between markets which compete to attract the most liquidity and offer the best prices. Together, competition *within* markets and competition *between* markets combine to create low transaction costs, innovative price discovery, and equal protection and choice for all investors—large and small.

Mandating all markets to interact, in identical fashion, at all price points, converts our markets into a government utility: If every market had to attempt to route to every quote on every other market, intermarket competition based on price discovery and liquidity aggregation would be lost because it wouldn't matter where an order had been placed. Our markets would be converted into a virtual Consolidated Limit Order Book or CLOB, a concept first envisioned in the late 1970's, then debated by Congress and the SEC in 2000. This proposal has been rejected numerous times, principally because it forces the convergence of all markets into one government utility, leaving them with only one method to differentiate themselves: how much they are willing to pay other market participants for their order-flow.

The CLOB proposal would "fix" what is not broken: Investors in U.S. listed stocks today benefit from competition between markets and from "best price" protection. As a result, spreads are among the tightest in the world, and transaction costs are among the lowest and have continued to fall steadily over the past several years. Investors can choose which type of execution they prefer based on the particular circumstances and strategy surrounding the stock they are trading. Retail and wholesale investors are treated on an equal footing. The SEC CLOB proposal would put all of these benefits at risk, and, indeed, put an entire equity market, the New York Stock Exchange, at risk.

The SEC has not considered the costs or the practical implications of actually implementing a CLOB: The CLOB alternative is a radical introduction that will require extensive industry planning in order to address the myriad consequences. For example, there has been no public consideration of the exponential expansion of message traffic and order routing chaos that its proposal would provoke. Attempting to trade with every price point on every market, given very uneven fill rates, would lead frequently to bad execution experiences for investors.

The proposal will undermine the NYSE's Hybrid Market: The SEC has put the CLOB proposal on the table at the precise time that competition is transforming the largest equities market in the world: the NYSE stands at the dawn of implementing its new Hybrid Market. The Hybrid Market is all about investor choice—offering in one marketplace both the ability for negotiated auction trades and lightning-fast electronic ones. The ability of any exchange to conduct a floor auction would be significantly undermined by the CLOB. The SEC should not force through dramatic regulation-driven change at a time the NYSE is implementing significant changes on its own.

Technology alone should not dictate how investors are treated: A 100% computer-based market system eliminates any potential for human judgment at the point of sale. The human element is important throughout the day, and particularly critical during times of market duress, earnings surprises, and corporate takeovers. Specialists and floor brokers deliver real value to investors and issuers—the 51 companies switching their listing from electronic-only markets to the NYSE in 2002 and 2003 found their intraday volatility cut in half. Lower volatility lowers the cost of capital for companies, which explains why companies cite dampening excess volatility as the single most important criteria of market quality. As lower volatility enables companies to raise capital with confidence, it also enables institutions to discover the "right" price for large blocks of stock.

The SEC proposal will hurt retail investors and weaken U.S. competitiveness: On the practical level, the virtual CLOB eliminates the opportunity for a negotiated trade within the system. In a splintered, electronic-only marketplace where exchanges must chase displayed orders from market-to-market, large orders of stock would be difficult to manage. Instead, they could be traded in private markets or overseas.

The SEC also recommends extending the government-mandated monopoly for market data: A separate part of the SEC proposal would mandate the creation of a single information consolidator for every market's full book; the SEC would have ultimate control of its operation and pricing. This would significantly increase infrastructure costs for markets and vendors, costs that will ultimately be passed onto consumers. Customers would be forced to subscribe and pay for every market's information whether or not they find value in it. It would also exacerbate the economic distortions of the current government-mandated monopoly that has provided the fuel for practices such as payment for order flow, wash trading, and tape shredding. The recommendation runs contrary to the Seligman Commission findings that concluded, after extensive study with all industry participants, that investors are best served when markets compete to develop and disseminate information products.

The SEC can ensure investors receive the best price by balancing inter-market competition with protection of the best prices in each marketplace: The SEC should maintain best price protection for those orders willing to be the best bid and offer in each marketplace; it should not destroy innovation and the bases for competition between markets by adopting a virtual CLOB.