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January 19, 2005

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

Re: Proposed Regulation NMS (Reg NMS)
Release Number 34-50870;
File Number S7-10-04

Dear Mr. Katz:

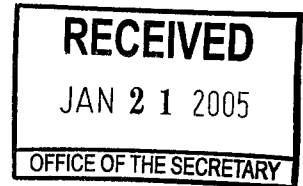
The Security Traders Association (STA)¹ commends the Commission and its staff on the open dialogue it has undertaken regarding Reg NMS. We are particularly pleased that, in addition to our comment letter, we have been given the opportunity to testify, before both the Commission and the Congress, at hearings held on this important initiative.

In response to the Commission's latest proposal and in the spirit of continued dialogue, the STA would like to briefly summarize and reiterate its views and the rationale for the positions we have taken.

We believe that the goals established by Congress in 1975 for the National Market System were correct. We agree with the Commission on the need to "update" markets to reflect technological changes in the 30 years since passage. However, STA believes that current objectives can best be achieved through a phased approach. We believe that the balance of competition and investor trust can best be achieved through fully connected markets.

¹ The STA is a worldwide professional trade organization that works to improve the ethics, business standards and working environment for our members. There are approximately 6,000 members, all engaged in the buying, selling, and trading of securities. Members participate in STA through 28 national and international affiliate organizations and represent the interests of the trading community and institutional investors. The STA provides a forum for our traders, representing institutions, broker-dealers, ECNs, and floor brokers to share their unique perspectives on issues facing the securities markets. They work together to promote their shared interest in efficient, liquid markets as well as in investor protection.

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Our organization has long recognized and supported appropriate regulation. However, we fear that over-regulated markets do not serve investor interests and will ultimately lead to unintended consequences which would violate the founding principles of the National Market System.

Background

In the 1990s, regulatory, competitive and technological changes converged to drive unprecedented changes in US markets. To be sure, many of the changes have had a positive effect on the markets. Some structural changes, specifically decimalization, proved to be a double-edged sword - and others have been harmful to investing.

Reg NMS represents a comprehensive and logical extension of the National Market System and is necessary to deal with the current environment and to set a framework for markets moving forward. In light of the comprehensive nature of Reg NMS, we believe it needs to be driven by broad principles rather than by a granular approach. Regulation NMS must be promulgated to achieve the principles that will make our markets fair and efficient. Our detailed perspective is in the comment letter we submitted on June 30, 2004 in response to the Commission's concept release.

The stakes could not be higher. Reg NMS will no doubt have far reaching implications for the investing public and their financial security. Strong and efficient equity markets benefit companies, large and small. The attendant effect on secondary and tertiary stocks and the ability to raise equity capital is critically important to the health of the U.S. economy.

In August 2003 the STA issued a White Paper entitled, "*Fulfilling the Promise of the National Market System: STA's Perspective on U.S. Market Structure.*" That paper was the first articulation of the principles of connectivity and access, which we believe, essential to drive the NMS market structure.

Currently, the US equity markets successfully trade some 3-4 billion shares each day, many of which are executed by our 6,000 members. We do not seek a business advantage from NMS, rather a level playing field for which to transact business and an environment that allows for competitive forces to flourish. We

have consistently presented a cogent argument (even prior to the Commission's initial concept release on Reg NMS) that the time had come to secure the NMS.

The STA's Perspective and the Future of the U.S. Markets

- **A Phased Approach**

The STA believes that the Commission should mandate connectivity and access between market centers and participants as the next phase in the ongoing construction of a true NMS. The phased approach would set a forward thinking framework for a true NMS while simultaneously allowing time to see if competitive forces, operating in such an environment, would prevent the need for further regulation.

The STA believes that connectivity will bring about the changes that most market participants desire, namely: more efficient and competitive markets; fair and equal access to markets; and more transparency. When these objectives are achieved, there will truly be an opportunity to consistently deliver best execution.

The STA strongly urges the commission to avoid overregulation in the markets, which would serve to impose exorbitant costs resulting in only small incremental efficiencies. Such additional regulation could serve to suppress competition and innovation by imposing regulations that bring unintended consequences.

In an online poll on the Traders Magazine website, respondents were asked their preference on trade through protection: top of book, full depth of book, or our recommended phased approach. An overwhelming majority supported the phased approach.²

² In an informal poll commissioned by the STA and conducted by Traders Magazine on their website, respondents were asked to submit their preferences related to the Commission's proposals for trade through protection (top of book or full depth of book). A third option, the STA phased approach was also included. As of January 11, 2005 370 responses had been received. 59% favored the STA phased approach compared to 19% voting for top of book and 22% preferring full depth of book protection.

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A phased approach is, in the realities of working markets, the only way to achieve these lofty goals. Recent history has shown us how a mere footnote, as in the order handling rules, can have significant implications that may, or may not, have been intended. Reg NMS has four major rule changes (Trade-Through, Access, Sub-Penny and Market Data) that all will interact in ways not totally predictable. This concern for the unforeseen argues for the STA's cautious approach.

In light of this position, we are opposed to more regulation without demonstrable evidence that such regulation is necessary directed towards truly fulfilling the NMS mandate; and will minimize unintended effects.

There is a direct correlation between market efficiency and the robust strength of any market. To gain such efficiency, the proposed regime should include automated execution of orders and automatic refreshment of orders as they are filled. In the interest of efficient and accurate price discovery and efficient intermediation of order flow, we believe there should be no "tolls" on access, such as currently exist with access fees. In the absence of a prohibition of access fees, we support the Commissions proposed cap of \$0.003. We do however have concerns about the language contained in the release. We urge that "all" trades should be so capped not just "protected" orders.

The approach detailed above is entirely consistent with the intention mandated by Congress when it set out a vision for such a national market system in 1975. Such an approach would at once achieve much of what the Commission articulated in its concept release while also mitigating unintended consequences. STA cautions the Commission to err on being conservative versus subjecting a highly successful and efficient market to degradation through unintended consequences. There is no substitution for learning how structural changes of this magnitude impact the most efficient market center in the world.

If market centers are fully connected, the NMS would serve to propel the competitive forces envisioned by Congress rather than from regulatory fiat (often, by definition, a choice of one interest or model over another). In such a connected and competitive environment, each market center would have to compete for order flow based on its offerings to investors and the efficiency of its model. There exists substantial evidence that competition is good for a

marketplace. Liquidity would gravitate to the most efficient provider of quality execution. Entities that developed and continually enhanced their offering to meet and exceed client demand would flourish, and those market centers that could not continually reinvent themselves would not earn market share. To this end, competition and constant innovation would be the engines of our capital markets.

The NYSE Hybrid is a good example of a business responding to its clients needs. This important initiative is market based. While we reserve judgment of the hybrid as it is still a work in progress - it is pushing the NYSE toward a more fully connected NMS. The process is working. The marketplace will decide if it is an effective solution to current perceived problems with the trading of NYSE stocks.

The phased-in approach will benefit investors as it allows for a considered approach to building the NMS. Investors would be the first to benefit from a fully connected market easing achievement of best execution in an efficient, cost effective manner. In such an approach, costs will be contained and unintended consequences will be reduced. Such a market will generate efficiencies and the development of competitive offerings that move well beyond the current trade through debate to a more fully robust US equity market.

- **Access to Public Quotations**

In its reissued proposal the Commission articulated two options: protection of each market center's BBO (best bid/offer); and the protection of the full depth of book for those market centers that choose to display full depth on a voluntary basis.

Again, STA believes that the phased approach will achieve market efficiencies, while at the same time protect against the unintended consequences of implementing the NBBO (national best bid/offer), the Top of Book or the Depth of Book proposals. We restate the position that in a connected market, which allows immediate access to published quotations, best execution will be far more likely and consistent. We support a process that uses NMS objectives as a continuous goal. The Phased Approach will allow for the collection and analysis of factual information sufficient to make informed decisions as to the need, or lack thereof, for further regulation.

In its comment letter of June 30, the STA recommended that the Commission adopt a rule requiring that all market centers and exchanges - NASDAQ, ECNs and market makers – provide automated trading access to their publicly displayed quotes for listed and NASDAQ stocks. The STA did not advocate any one model over another for how orders should be routed to reach a market center's quote. In particular, we do not believe it is necessary to mandate formal intermarket linkages under a national market system plan. We do believe however, that non-SRO market centers such as ECNs must make their quotations available for auto-execution through the facilities of an SRO. In this way, other market participants will only have to maintain access to six or seven markets, not to dozens.

Market integrity and investor confidence are tied together. This relationship determines the strength of any market. One of the more important components of market integrity and confidence is the knowledge that the quotes in the market are understandable and reliable.

If manual quotes become part of the NBBO, and are not automatically accessible to the investing public, the result will be that the quote itself may be compromised, and investors will be confused. Only orders immediately accessible to the investor should be part of the NBBO. Seen in the light of best execution, if quotes cannot be automatically accessed, the industry will likely be held to a standard which by definition will be impossible to meet.

Finally, both long and short term investors bring liquidity to the market. As the Commission strives to build a true NMS, we urge the Commission to avoid regulations that will benefit one set of investors over another. Selecting one investment strategy over another is best left to competition and investor choice. Setting regulation by investor type will set a dangerous precedent that will surely breed negative consequences.

- **Locked and Crossed Markets**

The STA has long called for the elimination of locked and crossed markets and supports the Commission's proposed rules to eliminate this practice. Further, the STA supports rigorous SRO enforcement of these new rules, closely monitored

by the SEC. The integrity of the quote should be a basic tenet of any new regulation, and as such serve to underpin the quality of the market. It would be a disservice to the investing public and to the evolution of our market structure, to allow executable orders to instead lock and cross markets for a broker's economic gain, risking the customer's right to an execution. This confusion is fundamentally unfair to the investing public, and is a direct contradiction to market integrity. Customer protection mandates that this issue be dealt with firmly. This problem exists today and allowing it to continue will be at the expense of market reform and investor protection.

- **Access Fees**

Access fees are at the heart of the locked and crossed problem in that it is these fees that create the economic incentive to lock and cross. In addition, as ECNs do not display these fees in the quotes provided to the CQS, and therefore distort the true price of an offering – resulting in a compromised quote.

For these reasons, access fees do not serve market efficiency, and in fact work against such efficiency. The STA continues to urge that it is in the best interest of investors that such fees be abolished. Should the Commission decide that such fees serve investor interests; the STA agrees that all participants be given the ability to charge such fees and that the cap detailed in the concept release would be appropriate. However, such cap needs to apply to all orders, and not be limited to “protected” orders.

- **Sub-Penny Quoting**

Consistent with our position that the integrity of the quotation is paramount to a robust and efficient marketplace, the STA opposes sub-penny quoting.

One of the primary intentions of decimalization was to make prices clear and more easily understood by investors. Sub-penny quoting is designed to serve the commercial interests of a few entities at the expense of the many professional and retail investors who interact in the markets each day.

Sub-penny quoting will undermine the intended and achieved benefits of decimalization to the detriment of the quote, to investors and to all market participants. Sub-penny quoting allows for orders of inconsequential price improvement to gain superior standing to orders placed into the market on behalf of those wishing to maintain and quote in an orderly fashion. This is again an issue where the commercial interests of a few are enhanced at the expense of the broad market and the public.

- **Market Data**

The STA supports a market data regime designed to reward quality, “tradable” quotations and which discourages quotes that serve only commercial interests. Any changes that reward price discovery in favor of print factories will serve to enhance the market.

Currently, market data fees are distributed on the basis of the number of trades, which incents print shredding. This clearly works against achieving an efficient NMS. The market data regime needs to be constructed in such a way that this practice is eliminated. The monies currently being paid out as rebates should be used to reward practices that enhance the National Market Systems not to create circumstances that diminish market integrity.

- **The Trade Through Rule**

The phased approach recommended above would allow for the accumulation of real-time data sufficient to produce quality analysis of the effect of connectivity and access on the markets. From such analysis of meaningful sets of data, the Commission would be in a position to determine with some certainty whether further incremental changes are required, and to the extent additional regulation is warranted, precisely what the changes should be. In particular, we urge that there be no further changes in the current trade through regime until the effects of connectivity can be implemented and the impact of this change studied.

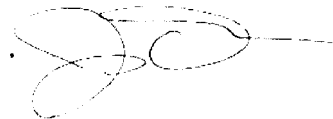
According to the Commission’s statistics, the rate of trade through is 2.3% to 7.2%, depending upon the underlying assumptions for the count. If connectivity and access are implemented the Commission will have a basis on which to

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evaluate whether these percentages are improved. STA joins with you in seeking to continuously enhance the quality of our great market system. We believe that our recommendations provide a prudent course of action through a continuous learning and evolving campaign to fulfill the promise of the National Market System.

On behalf of our 6,000 members we appreciate the opportunity to express our views. In these critical times for our nation and its investors, the securities markets must be part of an effort to pass on the legacy that we have so richly inherited.

Very truly yours,



James A. Duncan
Chairman



John C. Giesea
President and CEO

cc:

The Honorable William H. Donaldson, Chairman
The Honorable Roel C. Campos
The Honorable Cynthia A. Glassman
The Honorable Harvey J. Goldschmid

Annette L. Nazareth, Director
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