Mr. Chairman, Members of the Commission and Commission Staff:

My name is _____ and I am ______ of the Interactive Brokers Group. At my company we are very interested in the speed, certainty and cost of executing U.S. stock trades both on behalf of our customers and also as very substantial proprietary stock traders ourselves. Through our Interactive Brokers subsidiary we provide direct access online brokerage services to thousands of institutions and sophisticated individual customers. Our market making affiliate, Timber Hill, is one of the most active market making firms in options and other equity derivatives and we are among the largest users of the U.S. stock exchanges. We trade on Nasdaq, all the major ECNs and on the New York Stock Exchange, where we are a member and are among the top 15 Program Trading firms.

I would like to focus my testimony on the Commission’s proposed trade through rule. The proposed new rule will alleviate some of the problems that are caused by the current ITS trade-through rule and we strongly support its adoption. However, I would like to suggest some changes to the proposed trade through rule that would make it more flexible in its treatment of hybrid markets that are partly manual and partly electronic, and would create incentives for these hybrid markets to more fully automate their operations, while not penalizing them in the meantime while they do this.

As I will discuss in more detail in a moment, we believe that the proposed trade through rule should be adjusted as follows. First, the exception to the trade through rule that would allow an automated exchange to trade through a manual exchange in certain situations should be amended to focus not on the whether an exchange is manual or automated, but whether a particular quote disseminated by that exchange is manual or automated – an automated quote being one that is immediately electronically executable.
This flexible approach would eliminate the need for the Commission to make an all-or-nothing judgment about whether an exchange is automated or not. Instead, those quotes that are immediately electronically executable would get full trade through protection and those quotes that are not electronically executable would not.

Second, the ability for a customer to opt out of trade through protection should be limited to situations where a better quote at another market is not electronically executable  – in other words a market center never should be able to execute a customer order where there is a better quote on another market that can be hit or lifted electronically.

Conversely, there should be no limit to the amount by which an automated market can trade through a quote that is not electronically executable and is therefore not really firm.

Fourth, for those customers who do not want their brokers to take the time and risk of trying to access a manual quote and who prefer immediate electronic execution, the rule should be clarified to confirm that these customers can configure their online order entry software on their own computers to default to opt out or to automatically set the opt out flag when their orders are sent to their broker, rather than having to go through a slow, on-screen dialogue for each order, which would defeat the very purpose of the opt out.

Finally, the Commission’s proposed trade through rule should be altered to eliminate the requirement that broker-dealers disclose the price of a quote that was traded-through. Such disclosures would be misleading because they would imply that the manual quotation price that was traded through was actually attainable by the customer – when this is often not the case because such quotes may be slow or stale and not honored when an order is sent to trade against them.

Before addressing these suggestions in detail, I would like to make some general comments about the current ITS trade through rule. The ITS trade through rule is fundamentally flawed because it does not distinguish between quotes that are electronically executable and therefore are truly firm, and quotes that require manual execution and are therefore  – as a practical matter  – merely indications of interest. As any active trader in the nation’s stock markets will tell you, the handling of orders that are sent to a human being for manual execution is where most of the possibility for delay, neglect, or active mischief lies.

The public controversy over “trade-through rules” has been mischaracterized by many as a question of whether a customer would rather get an immediate execution on an electronic market, or wait a little while to get a better price on a slower, manual market. But the problem is that the customer may never get the better price that is supposedly
available on the manual market. The choice thus is not between a faster fill versus a better price -- it is between a faster fill and a better price that *may or may not be available by the time the customer's order is filled.*

There is good reason to believe that a bird in the hand (an immediate fill on an electronic market) is better than two in the bush. This is because manual exchanges are slower to update their prices than electronic ones. In a rising market with many buyers, for example, a manual exchange will show lower prices as the market is moving up. The current ITS trade through rule forces customers’ buy orders to be sent to meet these seemingly low prices, but by the time the customers’ orders are manually handled, the price will have moved higher – therefore customer orders will get filled at a new, higher price, or not filled at all.

In this way, the combination of a manual market and the trade through rule acts as a bait and switch mechanism disadvantaging customers and benefiting slow-market insiders. The solution to this problem is relatively easy: if a posted quote can be traded with immediately and electronically, the trade through rule should apply and the customer’s order should be routed to that market. If a posted quote is not electronically executable, however, that quote should be treated as what it really is – merely an indication – and the trade through rule should not apply. Such an outcome would provide customers with best-price executions and would encourage manual markets to improve their technology and offer truly firm quotes.

The Commission’s proposed trade through rule as drafted is a major step forward in that it correctly recognizes the substantial difference between a quote that is immediately electronically executable and one that must be executed manually. But the proposed rule could be improved substantially with a few alterations.

First, the exception to the trade through rule that would allow an automated exchange to trade through a manual exchange should focus not on whether an exchange is automated, but whether a particular quote disseminated by that exchange is automated. As is currently done in the options markets, each quote that is disseminated by a market center would indicate whether an order sent to hit or lift that particular quote would be automatically executed. Electronically executable quotes would be protected from being traded through but manual quotes would not.

Focusing on whether particular *quotes* disseminated by a market center are electronically executable would allow hybrid market centers like the New York Stock Exchange – where some quotes are automatically executable and some are not – to get the benefit of the trade through rule for those quotes that deserve it, and would provide such market centers with the flexibility to evolve toward automation as they see fit. This approach would eliminate the need for a debate about whether systems like NYSE Direct
Plus should be considered automated or not. Instead, each quote would indicate whether it was automatically executable, and trade through protection would follow accordingly.

This approach is technically feasible. Since each quote in the consolidated stream already has a single letter code indicating the exchange from which it comes, one way to differentiate a hybrid exchange’s electronically executable quotes from its manually executable quotes would be to simply issue an additional one-letter code to each hybrid exchange. The exchange would append one of its two codes to quotes that are electronically executable and the other code to quotes that require manual execution.

The second adjustment that we would make to the proposed trade through rule concerns the ability for a customer to opt out of trade through protection. The rule as drafted would allow a customer to opt out of the protections of the trade through rule even where the better quote being posted by another exchange is immediately electronically executable. We do not see any justification for a customer not to get the best nationally available price if the quote is a true, firm, electronically executable quote, and the Commission should not allow the opt out in this case. Moreover, as the Commission points out in the rule release, trade through rules are not only intended to protect customers who are liquidity takers, they also protect those who provide liquidity by posting limit orders. Someone who takes a risk and provides liquidity by posting a firm, electronically executable quote deserves to have that quote protected from being traded through, and the customer always deserves to get that best price.

On the other hand, the third adjustment we would suggest to the Commission’s proposed trade through rule would be to allow an automated market to trade through a manual quote by any amount, rather than limiting the trade-through exception to the one to five cent de minimis amount specified in the proposed rule. Limiting the amount by which non-firm, manual quotes may be traded through will simply create an opportunity and incentive for a manual market to adjust its quotes more slowly so that such quotes are off the true market by more than the de minimis limit – thus forcing orders to continue to be routed to them and preserving their free option to trade with incoming orders. This is a perverse result and would give the manual market the ability to defeat the Commission’s policy by simply moving its prices so that the exception could not be applied.

Our fourth suggestion also deals with the opt out provision of the proposed trade through rule. We do think that a customer should have the right to opt out of trade through protection and instruct his broker to execute immediately against an electronic quote rather than chasing a manual quote that may or may not be real. However, we ask that the Commission clarify the proposed rule to make it clear that customers using online order entry systems should be allowed to configure their own systems to default or automatically set the opt out flag for their orders, rather than having to go through a slow on-screen dialogue for each order, which would defeat the purpose of the opt out. The
purpose of the opt out right is to give customers who demand the speed and certainty of automatic executions the ability to instruct their broker accordingly. If the opt out exception is to be useful, it must be available as a default setting or automatic selection by the customer in his or her order entry software. Forcing these customers to go through a boilerplate onscreen disclosure dialogue for each order would serve no meaningful purpose -- especially since many of these customers are executing sophisticated investment strategies that require many orders to be transmitted in a short period of time or in many related securities simultaneously.

Our final suggestion regarding the proposed trade through rule is to eliminate the requirement that a broker disclose the price of a quote that was traded-through. This requirement will cause more confusion than it is worth and will result in disclosures that are as often as not entirely misleading. This is because disclosing a price that was traded through will imply to the customer that this price actually would have been attained had the customer’s order been sent to the manual market. But as we know, trade throughs are often the result of stale, slow, or misleading manual quotes that are in no sense real and tradeable. Disclosing these quote-unquote “prices” to the customer on a confirm or on a monthly statement will create the incorrect impression that the customer should not have opted out or that the broker is not using due diligence. Indeed, this requirement has the potential to gut the effectiveness of the opt out because brokers will be afraid of the confusion and potential negative reaction that these misleading disclosures will engender.

In closing, I would like to thank the Commission again for allowing us to present our views at today’s hearings. We think all of the elements of proposed Regulation NMS will add value to the National Market System and should be adopted, and we respectfully request that the Commission consider our suggested amendments to the trade through proposal to make that provision even more useful and forward-looking than the proposed version.