June 30, 2004

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth St., NE
Washington, DC 20459-0609

RE: [Release No. 34-49325; File No. S7-10-04]

Dear Mr. Katz:

Upon reading the transcript from the Commission's Public Hearing on Regulation NMS held April 21st and reviewing the Commissions Supplemental Release dated May 21st, I would like to make some further observations and suggestions to those made in my letter dated April 7, 2004.

Be Careful Regarding the NYSE Plans For Going Auto-EX

The NYSE intentions to make their Direct Plus Auto-ex for the BBO doesn't help the National Market System. What it does is to improve customer access to their market but only at the expense of the other market centers. Limiting Auto-Ex to the BBO still doesn't help the institutional investor who wants automatic execution over a range of prices similar to what's available in the OTC market.
Most important, it does not solve the fast/slow problem. New York will still be a slow market when using the Intermarket Trading System (ITS). The result is that investors preferring to go through other market centers will find it necessary to route their orders directly into the NYSE. Competition will diminish and with it the likelihood of a true national market ever developing.

Some would argue that investors would be better off with just one market center (i.e. the NYSE). But that was not the intention of Congress - nor anyone else for that matter.

The SEC must insist that NYSE commit to a market center linkage that meets the purpose expressed in the Exchange Act Amendments of 1975. As several of the panelists pointed out, the failure of ITS is not one of technology, but rather the way in which ITS is governed. To put it somewhat crassly: the NYSE has used it's veto power to prevent the Intermarket Trading System from becoming an effective linkage because, by being the dominant repository of limit orders, they want to discourage investor use of competing markets.

Upgrading ITS is the most direct, easiest and least expensive way of solving the fast/slow problem. It is the *only* direct way. It is within the commission's regulatory powers to mandate it and it would not require complicated access rules and multiple linkages. Finally the funds are available in the excessive revenues presently being collected by the Consolidated Tape Association (CTA).

Recall what you accomplished in the OTC market a few years ago. In response to an informal but effective cartel among market makers that kept the inside spread unnaturally wide, you recentralized the OTC market by establishing Order Handling Rules, working with NASDAQ to design SuperMontage, creating the ADF and involving the ECNs. All this while maintaining strong competition and encouraging innovation. The result was the re-creation of a true National Market System that enjoys exceptional competition, narrower spreads and myriad portals for investors to reach the market. An improved ITS would do the same for the listed market.

I recommend that the SEC hold additional Hearings focusing on the technology upgrades needed to make ITS work, the costs and timing involved and the role, if any, that the CTA would play in its funding and governance.

The SEC's Solution to Market Linkage is Cumbersome, Costly and Anti-Competitive

Mr. Concannon representing the NASDAQ said it best… "We do have some linkage in place, but I will tell you, bilateral linkages between two markets are very difficult to negotiate and complete, given the competitive interests of both sides."

The access proposals being suggested, if applied to the listed market, would entail unduly cumbersome and complicated layers of rules and regulation to protect against misuse of power by one side of the negotiation over the other. The detailed rules for conducting negotiations, the fees that would be charged, who's to pay and maintain, levels of redundancy required, who's to police, rights to complain, etc., will throw the SEC completely into the process from beginning to end and would take "the market force at work" out of the process. The costs of these myriad bilateral access links would be particularly burdensome to the smaller market centers.

An ITS type structure would have each market center responsible for financing, building and maintaining its linkage to a central processor which would be designed to hold and publish multiple layers of quotes with size from each participating market center. These quotes would be available for execution whenever the central processor received a counter bid or offer. The speed of ones linkage and level of input becomes academic. No fees are involved. The CTA finances only the development and maintenance of the central processor. What could be simpler, fairer and more conducive for competition among market centers?

It is Time to Restructure the Consolidated Tape Association (CTA)

Several panelists questioned the excessive revenues and unfair structure of charges established by the CTA. They also mentioned, with reference to the un-workability of ITS, that the problem was not technology but rather one of governance.

The CTA was formed to insure that the public receive transaction and quote information from all market centers in readable form and to distribute among the centers whatever revenues were received.

The NYSE insisted, as a condition of their participation, that its subsidiary (SIAC) be the consolidator of all the information and that NYSE have veto power over future changes to the system. This included any changes to the Intermarket Trading System (ITS). The other market centers went along as the revenue formula was slightly favorable to them and the ITS provided a no fee linkage into New York.

With respect to Market Data fees charged the public, the CTA bylaws provided that *they could be raised by a simple majority vote while <u>any reduction required a unanimous vote.</u>*

This arrangement was agreed to by the SEC with the consequence that market data revenues have become excessive and the ITS doesn't work.

Even a cursory examination of the numbers published in Regulation NMS causes concern. In 2003 revenues collected were $424,000,000 or

10 times the costs of consolidation. *In the case of Tape A (NYSE Listed Stocks) the ratio of revenues to cost is twenty to one.*

In his testimony, Bob Britz, President of the NYSE challenged the numbers as misleading, and stated that the net income received by The NYSE covered only 29% of the $488,000,000 spent by them in 2003 for collecting last sale and quote information. In contrast Bob Greifeld stated that his costs were a mere 30% of revenues collected on Tape C.

Another interesting comparison was Britz's claim that the NYSE spent $488,000,000 on Tape A while the five other market centers were receiving a paltry combined total of $7,623,000 in revenues to cover their costs. A third party observer has problems rationalizing the SEC numbers with the statements of Britz and Greifeld.

Information clarifying these inconsistencies should be supplied to the SEC and made public. In addition further hearings should be held to explore whether or not downward adjustments in data revenues be required and restructuring of the CTA be considered to remove the present cartel like structure which is not working in the public interest.

Regulation NMS Should Concentrate on Solving the Problem of the Listed Market.

Another way to say it: the problems of the OTC market are not National Market System problems. In fact, the OTC market is close to being a prototype for one. Yes, there are still issues that need correcting but on the whole, the package that includes the Order Handling Rule, the Super Montage, with the inclusion of ECN's and the creation of the ADF brought that market back together again.

Peripheral issues like Locked and Crossed markets, can be solved by a simple rule preventing brokers from being part of either, or a further interpretation of the broker's Best Execution responsibilities. What came across loud and clear at the Hearing was that the Trade Through Rule was unnecessary in the OTC market ("If its not broken, don't try to fix it") and that OTC access fees are reacting decisively downward to market pressures. *The SEC should concentrate on the listed market and leave fine-tuning of the OTC market for another day.*

Seize the moment

In reading the Commissions reaction to the NYSE assurance “to do the right thing,” analyzing New York’s actual proposals and noticing the several private meetings held since between the NYSE and SEC staff members, this old market structure buff becomes slightly paranoid.

My experience dating back to the Rule 394-B fiasco, the Fixed Commission Hearings, the consolidated tape negotiations and worst of all, the ITS disaster (which Commissioner Atkins observed “ was meant from the beginning not to work”), makes me chary of the Commission’s ability to bring about significant change on its own. Only when Congress or Justice have intervened, plus competitive forces, did it come out right. The NYSE is just too focused, too powerful and with too much at stake. *Keep the process public, press them for straight answers and firm commitments and remember the public investor***.**

The hearing reinforced this readers opinion that regulation NMS as proposed falls far short of Chairman Donaldson’s desire to produce a more effective National Market System.

In 1998, the SEC reacted forcefully to the disclosure of wrongdoing by some OTC market makers to cheat the public by means of cartel like arrangements to keep bid/offer spreads artificially wide.

The SEC should be equally resolute now. Use the disclosure of similar wrongdoing by the big five specialist firms that enjoy a monopoly franchise in the dominant market for listed stocks as the stick to bring real change.

As I mentioned in my previous letter, I would be pleased to participate in future hearings or committees concerning market-structuring issues.

Respectfully,

Donald E. Weeden