ROSENBLATT
SECURITIES INC.

March 8, 2005

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

Re: File No. S7-39-04, Proposed Rule and Concept Release concerning Self-Regulatory Organizations

Dear Secretary Katz:

The SEC has chosen an opportune time to (i) make specific proposals to strengthen the governance of the self-regulatory organizations (SROs) that are a fundamental component of the regulation of our markets and broker-dealers today and (ii) re-examine whether the inherent conflicts of interest in an SRO model warrant its abandonment altogether and replacement with an alternative model. Numerous developments call into question whether the status quo can treat competitors fairly, serve our capital markets and, most importantly, adequately protect investors. There are the recent scandals at the NYSE with respect to both executive pay and specialist improprieties. There is the debate raging about how Reg NMS should revamp the market data fees allocation formula (which has a huge impact on the SROs because of its role in providing the funding for SROs). There is the trend of marketplaces becoming for-profit entities, from the Chicago Mercantile Exchange (CME) and Nasdaq, which have done so in recent years, to the International Securities Exchange (ISE), which is in the process of going public this very week, and the NYSE, which has formed a committee to consider its options. Lastly, the competition for order flow among market centers simply seems to be getting ever-more intense, which raises legitimate concerns that marketplaces may abuse their SRO powers to gain a competitive edge, whether that be by using lax regulation as a means of attracting or preserving business[1] or using regulation as a club to fend off competitive inroads.[2]

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[1] As the SEC's concept release notes, the growing size of some of the major players in the marketplace exacerbates the inherent conflicts. Whether it's a specialist firm on the NYSE trading more than 25% of all volume on the Exchange and accordingly becoming a *de facto* more powerful member or an ECN deciding for tape revenue to print its order flow on a regional exchange that then becomes extremely dependent on that ECN's happiness for its literal survival, the conflicts inherent in self-regulation seem to be increasing. A particularly disturbing picture was painted by a former head of equity trading compliance at the Pacific

Without commenting on each of the individual components of the Commission's SRO Governance and Transparency Proposal, as a whole we think it is a sensible way to address the inherent and growing conflicts apparent at the SROs. However, we do not believe it will be necessary to go down the road of some of the more radical overhauls of the system explored in the accompanying Concept Release, such as termination of the SRO system in favor of direct SEC regulation of the industry or a market neutral single SRO to set standards/rules, conduct examinations and enforce rules. Considering that as a firm we are extremely sensitive to the types of conflict-of-interest questions raised by the SRO model,[3] why is that?

There are three reasons for our view. First, between the changes outlined in the Commission's SRO Governance and Transparency Proposal and the significant changes undertaken already by some of the SROs, most notably the NYSE,[4] we believe the conflicts can be effectively managed. Second, having been subject to both NASD and NYSE routine audits, as well as currently serving on the Hearing Board of the NYSE (our primary regulator) that hears cases and approves settlements between the Exchange and its members, we can attest to the seriousness with which examinations and enforcement is conducted. We would even note that the specialist investigations and ultimate multi-million dollar settlements came out of the NYSE's own surveillance mechanism. While it may have uncovered some bad apples operating within the system, the system of regulation itself actually worked. Third, and perhaps most importantly, our practical experience has led to a firm philosophical belief that the closer regulators are to the process, the more effective they become, and the further away they are, the less effective they become. Understanding the inner-workings of a market is no easy feat. Grasping the complexity of trading practices is a pre-condition to setting sensible rules, reviewing members' activities, and punishing wrongdoers. In fact, the NYSE made a deliberate decision a couple of years ago to put a surveillance group on the floor itself to be closer to the action. Distancing the regulator too far from the regulated activity risks the loss of valuable insights that will ultimately lead to worse enforcement. Even the SEC has in

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Exchange, who reportedly said in a recent letter to the SEC that "During my time at the exchange I was constantly pressured by senior management to lighten up on the members in a disciplinary way because of the constant threat that the members would take business elsewhere." *Traders Magazine*, February 2005, page 8.

[2] See, for instance, "Futures Markets are Both Players and Referees" in *The Wall Street Journal*, January 25, 2005, with respect to the accusations that the CME (which is regulated by the CFTC not the SEC) was using its self-regulatory powers to shield itself from competition from Euronext.Liffe.

[3] In fact, our whole business model is designed to avoid such conflicts in our own dealings with clients. We are one of those rare brokers that not only eschews principal trading, but also refuses to "shop orders", believing that while finding a second commission would be nice for our own bottom line, there is too much risk of information leakage and market impact to justify it.

[4] In the wake of former Chairman Grasso's departure from the NYSE, Chairman Reed and CEO Thain have completely overhauled corporate governance and transparency at the NYSE, including replacing an unwieldy board of directors with a smaller, nearly entirely independent board, establishing a new Chief Regulatory Officer position that reports to a completely independent board committee rather than operational management and providing for periodic disclosures of certain financial performance and management compensation information more akin to that required of public companies. In many cases these changes go even further than the SEC's SRO Governance and Transparency Proposal.

some sense already recognized this danger in last year's launch of the Office of Risk Assessment to bring in more personnel with direct industry experience to anticipate problems and help the SEC be more proactive in the identification of new and resurgent forms of fraud and other questionable activities.

Finding a workable balance between federal and industry regulation makes sense. In no way should the industry be given free reign. Sensible safeguards, like the SEC's proposals, must be put in place. The SEC (and for that matter a state attorney general) can and does step in when necessary, and should continue to do so. Federal oversight coupled with a vigorous and reformed SRO model that keeps regulators more intimately involved with practitioners offers a best of both worlds solution.

Sincerely,

Dick Rosenblatt, CEO
Joe Gawronski, COO

cc: Chairman William H. Donaldson
Commissioner Paul S. Atkins
Commissioner Roel C. Campos
Commissioner Cynthia A. Glassman
Commissioner Harvey J. Goldschmid
Annette Nazareth, Director, Division of Market Regulation
Robert L.D. Colby, Deputy Director, Division of Market Regulation