Bloomberg TRADEBOOK LLC
Member NASD/SIPC

June 30, 2004

Via e-mail: rule-comments@sec.gov

U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549-0609
Attention: Mr. Jonathan G. Katz, Secretary

Re: File No. S7-10-04

Ladies and Gentlemen:

Bloomberg Tradebook LLC ("Bloomberg Tradebook") submits the enclosed comments regarding proposed Regulation NMS under the Securities Exchange Act of 1934 (the "Exchange Act") published for comment by the Securities and Exchange Commission in Securities Exchange Act Release No. 49325 (February 26, 2004) (the "Release") and further explained in Securities Exchange Act Release No. 49749 (May 20, 2004) (the "Supplemental Release").

Bloomberg Tradebook is a global electronic agency broker and a compliant ECN. Our primary objective is to provide direct-market-access trading to clients of the Bloomberg Professional Service. In the case of equity securities, we have done this by aggregating and consolidating multiple liquidity venues — that is, exchanges and other market centers — into a single trading monitor for each security. We give our clients the ability to seek best execution, using pre-trade analytics, trading tools, execution strategies and post-trade, transaction-cost analysis.

We fully support the objectives of the Securities Acts Amendments of 1975 — efficiency, competition, transparency, best execution and direct interaction of investors' orders. We believe the Commission's proposed Regulation NMS takes positive steps toward those goals, but it does not adequately resolve many of the issues with which it deals.

EXECUTIVE SUMMARY

1. We support the proposed ban on subpenny quoting.

2. We would prefer to see access fees banned outright. We are concerned that the approach the Commission has taken is unclear in application and

potentially anticompetitive since it appears to reward some business structures while penalizing others without any apparent or commensurate benefit to investors.

3. The Commission's market-data proposal fails to deal with the underlying problem that market-data fees are too high. We believe the Commission should do more to carry out its statutory duty to assess their fairness and reasonableness, particularly if the Commission's regulatory powers over access fees are to confer immunity from the antitrust laws.

4. The existing Intermarket Trading System ("ITS") trade-through rule does not work. The Commission's proposed trade-through rule is unnecessary, would likely not work, would be very expensive to implement and enforce and would not provide a commensurate benefit to investors. We think the Commission instead should extend the existing pilot program for exchange-traded funds so that some class of equity securities that currently are subject to the ITS rule would be exempted in much the same way as EFTs. If the Commission nevertheless adopts a trade-through rule, it should allow unrestricted trade throughs against markets that do not respond immediately and automatically to inbound, offsetting orders.

DISCUSSION

1. <u>Quoting in sub pennies</u>

We support the Commission's decision to ban quoting in sub pennies. Bloomberg Tradebook has never enabled orders to be displayed in its system in increments of less than a penny, and for good reason. Our clients believe that quoting in sub pennies is used, not for bona fide price improvement, but to jump ahead of their limit orders. In conjunction with the publication for comment of Reg NMS, we recently carried out an informal survey of our buy-side clients. Of the 158 responses we received, 145 said they oppose quoting in sub pennies.

2. <u>Access</u>

Access fees. We applaud the Commission's effort to reduce access fees, but we would rather see them eliminated entirely for all quotations, including both quotations at the top of file and quotations above the best offer or below the best bid. The harm done by access fees to the markets occurs in three ways. First, access fees lead to locked markets. Second, access fees perpetuate rebates of various kinds, including payment for order flow; any fees that promote rebates and other ways of sharing revenues with order-entry firms invite fiduciary abuses. Third, access fees reward "slow" market behavior, that is, delaying the display and/or routing of customer market orders so as to internalize the trade and capture/save the access fee or fees. Fourth, access fees are coercive since under principles of best execution, broker-dealers must hit and take the best prices available. SROs and ECNs should be allowed to charge what the market will bear for the posting of limit orders on their systems. Order flow will move to those markets that offer the best combination of service, innovation and fees. But the marketplace should not apply fees to hitting bids or offers, for which choice does not apply.

We have urged for a long time that access fees in all their forms should be abolished.[1] Access fees diminish the transparency of market pricing because they are not accounted for in the published price. The Commission should take more direct action to eliminate access fees and should not broaden the base of market participants who can charge them. If, however, the Commission retains access fees:

a) there should be no distinction between "attributable" and "non-attributable" quotations as the precondition for charging an access fee;

b) only market makers and ECNs should be able to charge access fees, within whatever cap the Commission establishes;

c) the cap on access fees should not be confined to the top-of-file of market makers or ECNs, but should extend to quotations beyond the top of file; and

d) self-regulatory organizations ("SROs") that provide matching facilities should not be allowed to charge access fees, which amount to brokerage commissions, on a cents-per-share fee for their services.

In proposing that access fees be extended to SROs, the Commission opens for reconsideration an important issue.[2] We assume for purposes of this comment that the proposed access fees for SROs under Reg NMS would replace substantially similar current access fees such as the order-execution fees charged to access liquidity on SuperMontage. Should the Commission elect to extend access fees to SROs that provide matching facilities, we believe those fees should be per-transaction, not per-share charges. SROs do not act in the capacity of brokers, executing, clearing and assuming counterparty risk, but rather as central quotation disseminators and network service

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1 Bloomberg Tradebook charges access fees because we must pay our competitors' access fees on orders routed to them. For that reason, we cannot afford to forgo access fees unilaterally, but we would fully support an outright ban.

2 *See*, Securities Exchange Act Releases No. 44918 (October 10, 2001), 44910 (October 5, 2001) and 44899 (October 2, 2001). *See also*, letter of Bloomberg Tradebook to the Commission, dated November 7, 2001 (File No. SR-NASD-2001-71), commenting on Nasdaq's proposed per-share pricing schedule and related liquidity provider rebates.

providers. There is no justification for permitting SROs to charge commissions, that is, a cents-per-share access fee, when they do not assume the risks appropriate to those charges. If the Commission decides to permit SROs to charge access fees, those fees should be based upon the service model of SROs, not the business model of brokers that take counterparty risk.

The Commission's proposed Rule 610 has a number of problems. We believe the Commission's proposals regarding access fees would weaken market structure by creating an uneven playing field among ECNs and among exchanges, and by eliminating the ADF as a trading venue. Neither the text of the Release, nor the Supplemental Release nor the proposed rule itself provides a fully comprehensible description of the Commission's access fee proposals. As set forth below, our understanding of the practical implications of proposed Rule 610 and the Commission's access fee proposal is based upon our reading of the Release, the Supplemental Release and the proposed rules themselves, as well as conversations we have had with the staff of the Commission's Division of Market Regulation. These issues are not adequately discussed in the Release or the Supplemental Release and it is not clear why the distinctions were made:

- If Bloomberg Tradebook displayed its quotation on SuperMontage and the quotation were hit through SuperMontage, then SuperMontage and Bloomberg Tradebook could each charge an access fee of $0.001 per share, but if the quotation were hit directly on Bloomberg Tradebook, rather than through SuperMontage, Bloomberg Tradebook could charge the maximum permissible access fee of $0.002 per share.

- If Bloomberg Tradebook displayed its quotation on SuperMontage and the ADF and the quotation were hit directly on Bloomberg Tradebook, Bloomberg Tradebook could charge the maximum permissible access fee of $0.002 per share.

- But if Bloomberg Tradebook displayed its quotation only on the ADF and the quotation were hit directly on Bloomberg Tradebook, then Bloomberg Tradebook could charge a maximum access fee of only $0.001 per share.

- Market makers in Nasdaq securities could charge access fees only for quotations that were displayed and attributed through an SRO and that were hit through that SRO. Unlike ECNs under the proposed rule, market makers could not charge access fees when their quotations were hit directly, regardless of where they were displayed.

- A market maker or broker-dealer whose quotation appears on SuperMontage under the acronym SIZE would not be able to charge an access fee if its quotation were hit on SuperMontage.

- A specialist on the New York Stock Exchange (the "NYSE"), the American Stock Exchange (the "Amex") or a regional exchange would be able to charge an access fee of $0.001 per share for its best bid and offer displayed and attributed in the public quotation stream and the exchange also would be able to charge a maximum access fee of $0.001 per share when such quotations were hit.

- The proposed limitations on access fees apply to best bids and offers, that is, to the top of file only. For quotations beyond the top of file, ECNs would remain free to charge access fees up to the amount permitted under their current no-action letters. Similarly, the NYSE could charge any fee approved by the Commission pursuant to a fee filing for its OpenBook data, containing limit orders on the specialists' limit order books beyond the top of file, and for its Liquidity Quotes beyond the best bid and offer.

Proposed Rule 610 would have two adverse, albeit possibly unintended, consequences for ECNs and for the markets generally:

1) **The proposed rule would effectively dismantle the ADF**. INET, Instinet's ECN, uses the National Stock Exchange (the "NSX") as a "beard", but nevertheless would be allowed to charge a full $.002 even though the NSX effectively functions as a print facility and does not provide INET any facilities beyond what the ADF would provide. The ADF, because it is only a display facility, would not be able to charge any access fees. In addition, an ECN that displayed on the ADF alone, could charge only $0.001 per share when its quotations were hit. The same ECN, if it also displayed on SuperMontage and its quotation were hit directly, could charge an access fee of $0.002 per share. The result would be that the ADF would be unable to compete effectively for participation and would likely have to be closed. This is in sharp, and unexplained, contrast to the Commission's action less than two years ago in expressly conditioning approval of SuperMontage on the creation and implementation of the ADF as a competitive alternative to SuperMontage.[3]

2) **The proposal would thereby confer a significant advantage on INET**. Currently, INET displays its quotations on the NSX, but its quotations cannot be accessed through the NSX; INET's quotations are only accessed directly through INET itself. Under the proposal, INET would consistently be able to charge the maximum aggregate access fee of $0.002 per share on each transaction. Through rebates, INET would be in a strong position to attract order flow away from other ECNs that did not change their business plans to mirror INET's.

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3 *See, e.g., Order With Respect To The Implementation of Nasdaq's SuperMontage Facility,* Securities Exchange Act Release No. 46429 (August 29, 2002).

It is not clear what principles guide the Commission's proposal. Given its likely effects, proposed Rule 610 would be anticompetitive without any apparently justifiable reasons. Why, for example, should ECNs whose quotations are attributed and displayed only on the ADF not be able to charge \$0.002 per share just like ECNs displaying and attributed on SuperMontage, particularly if the result of that discrimination will be to cripple if not topple the ADF? Why should ECNs but not market makers be allowed to charge a full \$.002 per share if they display their quotations in SuperMontage or another exchange facility but are accessed through private wire connections? These points are not clarified in the proposed rule, or in the Release or in the Supplemental Release. If the Commission indeed intended in proposing Rule 610 to compel ECNs to change their business models and that the ADF be dismantled, we respectfully suggest the Commission should republish the proposal in a release fully discussing the issue, including the Commission's reasons for those steps and its belief that those steps are consistent with public interest and the protection of investors.

If the Commission nevertheless decides to retain access fees, a simpler and fairer alternative is possible. The Commission could let all participants that undertake counterparty risk charge a maximum access fee of \$0.001 per share, whether or not their quotations were attributed and displayed in the public quotation. SROs with order-matching facilities and others that do not undertake counterparty risk would not have those benefits — the definition of "order execution facility" in Rule 600(b)(50) would be revised accordingly. Print facilities and connectivity facilities would not be treated as brokerage, which is the predicate for access fees. Taking this step would eliminate what we respectfully suggest is an unfair and illogical discrimination in the proposal against the ADF and in favor of, e.g., the NYSE, Nasdaq and the NSX. It would allow access fees only to those actually providing a brokerage function, which was the original rationale for access fees.

5% fair access threshold. Today, an ECN that accounts for 20% of the trading volume in one or more securities must, with respect to those securities, establish written standards for participation and must apply them in an even-handed way to all participants and access brokers alike. Under the new proposal, the fair-access threshold would be reduced from 20% to 5%.[4]

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4 While existing Rule 301(b) under Regulation ATS is not clear on the point, we understand it is currently interpreted to mean that an ATS that crosses the 20% threshold with respect to one or more securities is subject to the fair access provisions with respect to those securities but not other securities in which it carries quotations. We further understand that the amendment will be construed the same way if the threshold is reduced from 20% to 5%.

From our conversations with the Division staff, we understand the Commission intends in the amendment to change only the numeric threshold and not to change any other aspect of the fair access provisions in Rule 301(b). Specifically, an ATS that reaches the 5% threshold will have to accept market orders received from any broker-dealer, except for those that refuse to pay access fees or that fall under the credit-related guidelines contained in the Richard Lindsey letter of November 22, 1996,[5] but will not have to offer to such broker-dealers other services the ATS makes available to its participants for commissions, including the ability to post quotations, access data and use an ECN's trading functions (e.g., reserve). ATSs, moreover, would not lose the ability to offer gradations in their fees to participants (e.g., fees that vary on the basis of aggregate trading volume) and could continue to use pricing to encourage participants to give them more order flow. On these several points, however, the Release can read to suggest other interpretations, which apparently were not intended.[6]

More fundamentally, 20% threshold in the existing Rule 301(b) under Regulation ATS balances appropriately the need to provide access to quotations and to prevent discrimination. ATSs that enjoy a 20% market share have begun to assume a critical role in the market and should take on a greater duty to accept participants than a market maker itself would have to. Dropping that standard to 5% in the case of ECNs such as Bloomberg Tradebook, which in large measure act as agency brokers routing orders to other market venues, would be arbitrary, capricious and inappropriately burdensome, particularly in the absence of any similar imposition on agency brokers that do not function as ATSs but that compete with Bloomberg Tradebook for agency business.

3. Market data

We support in concept the Commission's proposal to change the formula for allocating market-data revenues. We believe the Commission was correct in concluding that trade printing should not be the only determinant of how market data fees

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5 Letter from Richard R. Lindsey, Director, Division of Market Regulation, Securities and Exchange Commission, to Joseph R. Hardiman, President, NASD, dated November 22, 1996.

6 We suggest the reference in the Release to the "terms" an access broker would have to be offered is ambiguous and should be clarified:

> The new rule also would require each quoting market participant to make its quotations available, for the purpose of order execution, to all quoting market centers and all other quoting market participants on terms as favorable as those it grants its most preferred member, customer or subscriber.

Release in text following n.168.

are allocated. Other factors, such as quotation price improvement, quotation size improvement, display of quotations below the best bid and above the best offer, execution of large orders, providing automated trading facilities, rapid responses to incoming orders, etc. should be taken into account. We are not commenting on the algebraic formula the Commission proposed.

We question, however, whether these revenues should be available only to SROs. This special currency, which the exchanges use as a means of competing for order flow, should not be the exclusive province of exchanges, which have their own incentives — incentives that do not necessarily serve the public interest, particularly as several of them have become for-profit entities.

In its 1999 concept release on market information fees and revenues, the Commission noted that market data should be for the benefit of the investing public.[7] Market data is the oxygen of the national market system. The exchanges and the Nasdaq marketplace are not the sources of market data, but rather the facilities through which market data are collected and disseminated. Indeed, market data originate with trading participants themselves, including specialists, market makers, broker-dealers, ECNs and investors. Funneling market-data revenues to exchanges and Nasdaq and not to investors shifts the rewards from those who trade to those who facilitate trading.

Under the current system, market-data revenues provide SROs with funds to compete with other execution centers. For example, Archipelago Holdings ("Archipelago") recently filed an IPO registration statement with the Commission in which it reported some $23 million for 2003 revenue from market data. This was net of $7.5 million paid to the Pacific Stock Exchange for market regulation services. Archipelago further stated that it uses this revenue to compete with Nasdaq, the NYSE and ECNs, such as Bloomberg Tradebook. That is, the market-data revenues Archipelago receives as an exchange are, in effect, government-sanctioned subsidies that confer an unfair competitive advantage on Archipelago and similarly situated SROs.

The Commission has never required the SROs to relate their market-data fees to the actual costs of collecting and disseminating the data. The Commission's proposal with respect to market data would perpetuate the exclusive and lucrative franchise SROs enjoy over the collection, dissemination and sale of market data. We respectfully suggest the Commission must make a more detailed and searching analysis of the fairness and reasonableness of the NYSE and Nasdaq market-data fees — fees for

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[7] *Regulation of Market Information Fees and Revenues*, Securities Exchange Act Release No. 42208 (December 9, 1999).

what are essentially monopoly services — particularly if these matters are to be eligible for antitrust law immunity.[8]

In addition to questions regarding who owns market data and who shares in the revenue and the size of data fees, we believe the Commission ought also to revisit how much market data should be made available to investors. Here, decimalization has been the watershed event. Going to decimal trading has directly benefited retail investors. It has been accompanied, however, by drastically diminished depth of transparency and accessible liquidity. With a hundred price points to the dollar, instead of eight or sixteen, the informational value and available liquidity at the best bid and offer are substantially reduced.

The Commission should respond by increasing the mandatory disclosure — and a data vendor's duty to display — to encompass not only the NBBO but inferior quotations that are five pennies above and below the NBBO. The real-time disclosure of liquidity should not be left to "market forces", which can work in this instance only if disclosure is mandated. This would restore the transparency and direct access investors had before the advent of decimalization. The data also would be indispensable to an effective trade-through rule if the Commission determines to go forward with that proposal.

4. Trade throughs

We share with sincere proponents of trade-through rules a vision of a national market system that promotes order interaction and treats all orders and all investors fairly. We embrace wholeheartedly a market structure that protects all participants, large and small. Were a trade-through rule effective and necessary to achieve these ends, we would support it without reservation.

The current trade-through rule. In the case of NYSE-listed stocks, the current ITS trade-through rule has not served investors well. It has stood in the way of innovative technology and deterred investors from obtaining direct access to market data and liquidity. There is strong indication, moreover, that the ITS trade-through rule has not been enforced when it would require NYSE specialists to route orders to other markets.[9]

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8 *See*, *Gordon v. New York Stock Exchange*, 422 U.S. 659 (1975).

9 As Archipelago's Gerald Putnam has testified, the existing Intermarket Trading System trade-through rule in practice has been a one-way street since the NYSE has failed to require its own members to route orders out to ARCA and other market centers in compliance with the rule.

(Footnote continued)

For their part, the regional market centers tend to comply with the current trade-through rule while at the same time they are not able to protect their client limit orders from being traded through by the primary market. They are further disadvantaged because they are not permitted to execute incoming orders routed for execution against their customer limit orders when those orders are displayed and available, but away from the NBBO. The ITS trade-through rule requires regional exchanges and ECNs to reroute those orders to the primary exchange.

Nasdaq. In the case of Nasdaq-listed stocks, we at Bloomberg Tradebook have substantial practical experience with how and when our clients choose to trade through published prices. In our experience, the only market centers our clients regularly choose to trade through or around are the Amex and certain ECNs. Our clients trade around the Amex because the Amex is slow to respond and its quotations often are not firm. Some of our clients trade around one or two smaller ECNs that charge exorbitant access fees.

Before the advent of SuperMontage, it was common practice for our clients to sweep beyond the NBBO and to preference ECNs for their immediacy. At the time, Nasdaq displayed market-maker quotations that were not automatically executable. Often, the market makers took between 20 and 40 seconds to execute a trade. In some

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(*Continued footnote)*

> Empirical data shows that the NYSE trots out the trade through rule when it suits its competitive purposes, but ignores it when it does not. Here are some facts: ArcaEx runs software (aptly named "whiner") that messages alerts when exchanges trade through an ArcaEx quote in violation of the ITS plan. The whiner database reflects that ArcaEx customers suffered up to 7,500 trade-through violations in a single week by the NYSE. In fact, trade-through violations have actually risen most recently despite the glare of the regulatory spotlight on the NYSE. Since just this last the [sic] fall (2003), the annualized cost to investors of the NYSE specialists trading through ArcaEx's quotes has increase 3-fold from approximately $1.5 million to $5 million. On any given day, ArcaEx has a billion shares on or near the national best bid or offer. Yet on any given day, the NYSE sends only 2 million shares to ArcaEx over ITS when we have the best price.
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> We have confronted the NYSE with our voluminous data but to no avail. If, in the NYSE's own words, the trade through rule "serves to protect investors," then the NYSE has some "splaining" to do and needs to take corrective action forthwith to enforce and comply with the trade through rule in its own marketplace.

Written statement of Gerald Dean Putnam, Chairman & Chief Operating Officer, Archipelago Holdings, L.L.C., concerning "Market Structure III: The Role of the Specialist in the Evolving Modern Marketplace" before Committee on Financial Services — Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, United States House of Representatives, 108th Cong., 2d Sess., February 20, 2004, at p. 6.

cases, the result was an outright "decline" by the market maker. Even then, it was rare for our clients to completely ignore or trade through market-maker quotations. Rather, the market makers tended to get a proportionately smaller amount of order flow against their quotations. That occurred because, compared with ECNs, they were less reliable, that is, their quotations were less firm. Also, they did not execute immediately and they took longer to refresh their quotations. In contrast, ECN quotations were firm, they executed automatically and refreshed immediately.

Trade throughs and slow markets. The order-management systems, order-routing technologies, connectivity and service bureaus that brokers today widely employ let market participants reach every liquidity venue. These systems are designed to seek best execution at the lowest cost for both proprietary and client order flow. These systems let traders preference and prioritize liquidity destinations on the basis of cost, response time and other relevant liquidity parameters. In our experience, firms rarely trade through fast markets. Only slow markets routinely trade through fast markets — and that is not because they cannot access fast markets. It is because they choose not to.

If trade-through protection for fast markets is not necessary as a general matter, then a *de minimis* trade-through rule, that is, a trade-through rule that allows a fast market to trade through a slow one by just a little bit, is wasteful. In a market where participants already have all the incentive they need to route to the best fast-market price, the programming required by each participant to ensure that all participants do what they already intend to do amounts to expensive regulatory and systems overkill with no commensurate benefit to investors. Monitoring a trade-through rule with minimal thresholds for violation would require expensive and cumbersome programming. If a short-sale rule today is difficult to monitor and enforce in a decimalized market, a trade-through rule with differential thresholds would be even more difficult.

In addition to being wasteful, a trade-through rule may also be harmful to investors. Consider first that slow markets will freely choose to be slow markets. There will be little incentive for a market to elect to become a fast market if slow markets are to receive trade-through protection— even *de minimis* protection. Such slow markets may have genuine benefits for participants in terms of price formation and liquidity. But these benefits ought to accrue only as the result of competition. That would mean that the slow market participants themselves would have to bear the attendant cost, for example, in the form of missed trading opportunities. The alternative would be to perpetuate trade-through rules that would almost certainly impose a much higher cost that will continue to be borne by the entire investor universe of fast market participants.

To be sure, only slow markets that offer real benefits will be worth the sacrifice of fast-market trading opportunities. In open competition, the benefits will have to outweigh the costs. The best and fairest way to facilitate that result is to promote enhanced investor choice and have the investors themselves bear the costs of their own choices.

Trade throughs and volatility. We recognize that there has been substantial concern that the NYSE specialists provide reduced price volatility and that they need a trade-through rule to protect the NYSE market. Volatility is perceived to be greater in Nasdaq-listed stocks than in NYSE-listed stocks and it is suggested that the elimination of the trade-through rule would be harmful.

We should like to suggest that the greater volatility perceived in the Nasdaq market, as contrasted with the NYSE market, may be the consequence of Nasdaq's not having floor members to dampen volatility by using their time-and-place advantages to jump ahead of public limit orders by a penny or joining limit orders on behalf of not-held orders. One question that should be asked in that regard is whether volatility *per se* is good or bad. It may well be the case that slowing the market down, as a floor-based system does, dampens volatility because it gives the specialist the opportunity to find the other side, which a fast market cannot as readily do. Assuming that to be the case, the question is whether slowing the market down is appropriate at all, even if it does reduce volatility. If greater volatility, which may look more substantial in a decimalized market than it did in an eighth-point or sixteenth-point market, naturally results in a market that is not artificially slowed down, that may be an economically acceptable or even beneficial result.

The NYSE-listed companies have been led to believe they benefit from lower volatility, but that may not be a correct conclusion, particularly if what really is going on is an increase in the frictional cost of trading for investors, measured by the profits the NYSE floor members extract from the market. The public pays a dear price for the NYSE specialists' affirmative obligation, which may well be a code word for jumping ahead of public investors to take advantage of superior market information known only to those on the NYSE floor. The operating ratios of the specialists in most years is evidence enough of their privileged positions. The market, if suffused with greater competition, would quickly eliminate these asystematic returns.

Abolish the trade-through rule. A better solution than the Commission's proposal, we suggest, would be to abolish the trade-through rule altogether. If the trade-through rule were abolished for stocks listed on the NYSE, we expect our clients would tend to favor the fast-market venues, but would not ignore slow markets to the extent they afforded available liquidity. Fast markets would automatically execute against their quotations and refresh immediately and thereby earn more order flow over time. Orders residing on the slow markets beyond the top-of-file as well as upstairs and hidden orders in the crowd would be traded through, and rightly so. Market centers that promote greater transparency, greater efficiency, greater liquidity and less intermediation facilitate the goals of the national market system, as envisioned in the Exchange Act.

As a result, we believe the best outcome for the markets would be for the Commission to entirely eliminate the trade-through rule. We think brokers and investment managers will be motivated by their agency and fiduciary duty to seek out the best prices for their orders.

If the Commission is uncertain whether a trade-through rule would be useful, the best approach to take would be to refrain for the moment from adopting the proposed Rule 610 and instead expand the pilot-program exemption for exchange-traded funds ("ETF") from the ITS trade-through rule. Taking that action would provide data to guide the Commission in evaluating the efficacy of the ITS trade-through rule and in determining whether eliminating that rule would be as beneficial for the markets in equity securities as it has been for markets in ETF securities. As the Commission knows, the added competition for the American Stock Exchange market has led to narrower spreads and improved markets.[10] The results of the ETF experiment have only been positive and it may well be that expanding that pilot program would produce similar results.

If the Commission nevertheless adopts a trade-through rule, it should take pains to assure that the rule will not slow the markets down to the lowest common denominator of the exchange markets. A trade-through rule should apply only to quotations published by markets that respond automatically to incoming orders without manual intervention and that execute the orders or reject them and update their quotations automatically, all within a fraction of a second and all without manual intervention by anyone.

If slow markets are going to be permitted to participate in the national market system — and we think to do so would perpetuate an anachronism — then the Commission should allow fast markets to trade through slow markets without limitation. Anyone quoting in the national market system should display firm quotations for the amount posted and those quotations should be immediately accessible, as described above. Markets that do not offer such immediately executable, or "touchable" orders do not have truly "firm" orders and they should not be published in the same manner as orders that are immediately executable. For auto-ex markets, the Commission should set minimum standards for the display and dissemination of quotations coupled with access for immediate and automatic execution. If slow markets are to persist at all, they should have separate published quotations and there should be no regulatory obstacles to trading through them.

The suggestion that the Commission should distinguish under its trade-through rule between fast and slow quotations rather than between fast and slow markets has some appeal, but may not be a complete answer. If there were two clear tracks and slow quotations would never have any rights to trump fast quotations — which they should not because, as the NYSE runs its market, the slow quotations are indicative and not firm in practice — then the trade-through rule could and should effectively ignore the

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[10] *See* Terrence Hendershott and Charles M. Jones, "Trade-Through Prohibitions and Market Quality," April 8, 2004, unpublished working paper available at: http://faculty.haas.berkeley.edu/hender.

slow track. We leave it to others to argue whether there should nevertheless a fast-to-fast opt out. As an ECN, we do not perceive why that should be the case if "fast" truly means fast, that is to say, execution or rejection, notice back and quotation refreshment within a fraction of a second.

We note, furthermore, that if the purpose of the Commission's proposed trade-through rule is to protect limit orders, it is inconsistent with that goal to permit internalization of limit orders by competing market centers. Permitting one market center to match a better priced limit order displayed on another market center undercuts the incentive for placing a limit order, thereby weakening the price discovery process. Also, even within a given market, the absence of time priority means that limit orders have no protection against later-placed orders and there is therefore little economic incentive to place limit orders.

In closing, we note with concern the projected regulatory and systems' implementation costs of the trade-through proposal, which the Commission itself has estimated in the Release at hundreds of millions of dollars. We do not believe those costs are justified by the perceived trade-through risks to investors.

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We appreciate the opportunity to offer Bloomberg Tradebook's views to the Commission on these important issues. We hope our comments prove useful to the Commission and its staff in their ongoing deliberations regarding market structure. If the Commission or any members of the staff wish to discuss these matters with us, please let me know.

Respectfully submitted,

Kim Bang by RDB

President and Chief Executive Officer

cc (w/att): The Hon. William H. Donaldson, Chairman
The Hon. Paul S. Atkins, Commissioner
The Hon. Cynthia A. Glassman, Commissioner
The Hon. Harvey J. Goldschmid, Commissioner
The Hon. Roel C. Campos, Commissioner
Annette L. Nazareth, Esq., Director,
Division of Market Regulation
Robert L. D. Colby, Esq., Deputy Director,
Division of Market Regulation
Giovanni P. Prezioso, Esq., General Counsel