Eric D. Roiter
Senior Vice President and General Counsel
Fidelity Management & Research Company
82 Devonshire Street
Boston, MA 02109-3614

June 22, 2004

U.S. Securities and Exchange Commission
450 5th Street, N.W.
Washington, DC 20549-0609

Attention: Mr. Jonathan G. Katz, Secretary

Re: File No. S7-10-04, Regulation NMS, Release Nos. 34-49325 (February 26, 2004) (the "Release") and 34-49749 (May 20, 2004) (the "Supplemental Release")

Ladies and Gentlemen:

I am writing on behalf of Fidelity Investments to offer our views on the Commission's proposed Regulation NMS. We confine our comments to the core market structure feature of Reg NMS: the trade-through rule. If adopted, this rule would require every U.S. market center for the trading of equities to have procedures that prevent trades from occurring at prices that are below the highest bid or above the lowest offer quoted in another market center.

The proposed trade-through rule would not apply in either of two circumstances. First, trades would be allowed to take place even though a higher bid or lower offer were quoted in another market, if the latter were a slow or "non-automated" market. This exception recognizes the considerable risk that a quoted price in a non-automated market will not be available to an investor by the time his or her order, sent first to another market center, is re-routed to the non-automated market for execution. The NYSE, under its current trading rules, is the prototype of a slow or non-automated market as contemplated by Reg NMS.

Second, the Commission is proposing, subject to conditions, to allow informed and willing buyers and sellers to "opt out" of the trade-through rule and to trade with one another at agreed-upon prices even though for any given trade another market is displaying a price that would be more favorable to either the buyer or seller (but, by definition, not both).

Our comments here supplement the written statement submitted on behalf of Fidelity by Mr. Scott DeSano, head of Fidelity's Equity Trading Desk, who participated in the Commission's public hearing in New York City held on April 21, 2004 ("April Testimony"). A copy of our April Testimony is included as Attachment A to this letter.

I. Summary

1) We urge the Commission not to adopt the proposed trade-through rule because it will impede competition among market centers. The government should permit market centers to compete based upon a wide range of factors that are important to investors, including efficiency, reliability, transparency, fairness, innovation, and costs to investors. These factors all bear upon best overall prices for investors — which are not necessarily achieved by "walking" the market up or down — and hence "best execution."

2) If the Commission adopts the trade-rule, we strongly urge retention of an "opt out" right. An opt-out provision is crucial to allow professional investment managers, such as Fidelity, to perform their fiduciary duties to the fullest extent in seeking best execution for the mutual funds or other accounts under their management.

3) A trade-through rule is not necessary to promote best execution or efficient pricing in the equity markets. Order flow will naturally gravitate to market centers that respond to investors' needs. Economic self-interest and fiduciary duty will lead investors to the markets providing the best combination of low transactional and access costs, speed, reliability, liquidity and innovation. These factors all contribute to best overall prices for securities trades.

4) To promote best execution, the Commission should focus its efforts on reforming rules within the NYSE's own market that confer informational and trading privileges on NYSE members solely by virtue of their physical presence on the trading floor. These rules deny time priority for investors' limit orders in the specialist's book over bids and offers made later in the day at the same price by brokers in the trading crowd or by the specialist trading for his own account.

5) The Commission should also require changes to the NYSE's rules that today prevent a willing buyer or seller from automatically "sweeping" the limit order book at prices that investors have freely committed to accept or, for that matter, at a single price that gives all limit orders being swept the most favorable price. Adopting an inter-market trade-through rule without first reforming the NYSE's own trading rules and market structure will simply reinforce anti-competitive features of the NYSE's market.

II. The Trade-through Rule Should Not Be Adopted.

The Commission's proposal would impose for the first time a trade-through rule across all markets. The rule takes the form of an obligation imposed on market centers, but its practical effect would be to prevent investors from trading in their market of choice. This is at odds with the Commission's long-settled policies on market structure, which historically have sought to expand freedom of choice for investors and to impose restraints only on those who owe special duties to investors under the Exchange Act, namely, broker-dealers, securities exchanges, and other market centers.

Investors have never been deemed under the Exchange Act to owe duties of "fairness" to other investors in the trading markets. Our markets rest on a different premise, namely, that the greatest public good is directly tied to the freedom of investors to make their own decisions regarding when and where to trade. If anti-competitive obstacles in markets are removed, and investors have the freedom to choose, market forces and economic self-interest will naturally cause buy and sell orders to flow to the market offering the most efficient pricing and execution services.

As the Commission well knows, the Intermarket Trading System ("ITS") trade-through rule, which purports to limit trade-throughs across exchange markets,[1] has been singularly ineffective. The ITS has not protected or encouraged limit orders on regional exchanges. Rather, it has conferred upon the NYSE specialist a right of first refusal before deciding whether to re-direct an investor's order to another market center that first displays a bid or offer at a superior price. Why is this so? The NYSE specialist acts as both referee of and participant in trading on the NYSE floor, an inherent conflict of interest. The specialist, as the only NYSE floor member granted the privilege of trading for his own account, is under no obligation under the ITS trade-through rule to send an investor's order to another market first displaying a superior bid or offer.

The specialist is in the enviable position of taking a last look and can exercise a right of first refusal (in effect, a free call or put option) by simply matching the other market's superior bid or offer. As a result, regional exchanges and other market centers have little incentive to quote prices that narrow the NYSE spread because the NYSE specialist stands in the way of their attracting market share away from the NYSE. The ITS trade-through rule (when

---

1 *See*, e.g., New York Stock Exchange ("NYSE") Rule 15A.

observed) has had the perverse result of impairing inter-market competition rather than encouraging the placement of limit orders on markets competing with the NYSE.[2]

The Commission is not proposing to include in its trade-through rule a requirement for inter-market time priority for quotations, that is, a queuing of bids and offers in different markets at the same prices according to the time they are first quoted in a given market. It is understandable that the Investment Company Institute and other commentators urge the Commission to take this additional step and thereby deny the NYSE specialist a right of first refusal. The Commission apparently has refrained from proposing inter-market time priority for same-priced bids and offers in the belief that the trade-through rule's distinction between automated markets and "slow" markets makes inter-market time priority unnecessary. In other words, why impose a time priority requirement if the trade-through rule protects only those orders placed in automated markets, since any willing buyer or seller can instantaneously "hit" the best bid or offer without interference or interruption from the NYSE specialist or any other market participant?

If this is the Commission's premise, we do not share it. Assuming the NYSE takes the minimal steps necessary to persuade the Commission to recognize the NYSE as an

---

2 The Archipelago Exchange has testified that the NYSE specialists trade through ArcaEx limit orders hundreds of times a day without any risk of enforcement action by the NYSE:

> 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 … fall (2003), the annualized cost to investors of the NYSE specialists trading through ArcaEx's quotes has increased 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.
>
> 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, U.S. House of Representatives, 108th Cong., 2d Sess. (February 20, 2004), at 6.

"automated" market, it should be anticipated that the NYSE specialist, when it suits his purposes, will adjust to the trade-through rule simply by improving his quotation by the smallest amount possible, to match the earlier superior bid or offer on another market center. As is the case today, the competing market center first in time with a better quotation has no right to be the first to trade at that price.

Despite the appeal of an inter-market time priority rule, we do not recommend that the Commission add this to its proposed trade-through rule. Rather, we recommend that the Commission not adopt the trade-through rule at all. As we say above, we strongly believe that the Commission should not adopt rules that prevent willing buyers and sellers from trading at agreed-upon prices. Given the widespread, timely disclosure of quoted bids, offers, and trades in our competing equities markets, federally mandated order-routing rules are simply not necessary. Fragmentation is a problem only when prices are hidden from public view, not when they are widely disclosed and all market participants can make informed decisions about the prices at which they are willing to trade and are able quickly and easily to reach those prices.

We urge the Commission not to adopt the trade-through rule for a second reason. By attaching sole importance to quoted bids and offers, the trade-through rule overlooks other factors that bear directly on obtaining best execution (including best all-in pricing) and promoting competition among markets. For example:

- What are the out-of-pocket costs that a market center imposes on investors? These may include not only access or transactional fees, but also market data costs. Market centers differ in their pricing of supplemental market data, that is, market data other than best bid or offer quotes and last sale reports. Some markets charge separate fees to investors who seek to view the depth of quoted bids and offers — which, as the Commission is aware, has become much more important upon the introduction of decimalization. Even among markets who charge such market-data costs, pricing may vary significantly. From the investor's standpoint, best execution involves not only the price at which a security is bought or sold but other costs which investors must pay to enter into and clear their trades.

- What is the liquidity and depth of any particular market center? Again, if a market center charges a fee to an investor for the "privilege" of seeing the depth of quotes away from the best bid and offer, should this market be viewed by investors as offering liquidity comparable to that of another market center that discloses the depth of its quotations for no fee or lower fees?

- What is the quality of a market center's program of self-regulation? How well does a market center monitor the trading activities of its members and how strong or consistent is its record of disciplining members who violate its trading rules?

- How fair are the market center's trading rules? Does a market center confer special privileges on some of its members that give them an advantage over public investors?

- How competitive is a market's own trading venue? For any given security, does it allow for competing market makers or does it confer a monopoly market-making privilege on a single member?

- How efficiently, quickly and reliably does a market center confirm trades occurring in its trading venue? The advantage to an investor of being able to enter into automated trades on a given market can be undermined if confirmations of those trades are marked by delay or uncertainty.

- How quickly does a market center refresh its quoted prices after a trade occurs? This is crucial to investors seeking to effect large transactions in stages.

- How well does a market center maintain the anonymity of investors placing orders in that market?

The Commission's trade-through rule is likely either to foreclose or to seriously hamper the ability of investors to take these and other factors bearing on best execution into account when choosing a market center in which to trade. Investors should be free to take a number of factors into account in seeking best execution, rewarding market centers that promote best execution and disciplining those that do not.

III. The Opt Out Right Is Essential if a Trade-Through Rule is Adopted

The Commission made the right policy choice in proposing an unrestricted opt out right from its proposed trade-through rule.[3] An opt out is particularly needed to protect investors in dealing with manually operated markets that hold up order execution and permit specialists and other floor members to trade alongside limit orders or incoming orders, or to jump ahead of those orders by a penny or two. Whether manual markets slow down order executions by as much as 30 seconds, which today is the case, or even by as few as six or seven seconds, which we understand may in the future be true, the very fact that executions are being slowed down costs investors money and exposes them to heightened risk of "missing the market," the risk that trades which could have been consummated at a stated price with ready and willing counterparties will be unavailable to them.

In our view, as a fiduciary to the mutual funds under our management, we should be free to reach our own informed judgment regarding the market center where our funds' trades

---

[3] Paragraph (b)(8) of proposed Rule 611 provides an appropriate opt out. In contrast, paragraph (b)(9) — which provides a more limited opt out — would be difficult to implement, particularly in fast markets, and is unnecessarily complicated, in our view. If paragraph (b)(8) were adopted, we do not believe paragraph (b)(9) would be needed.

are to be executed, particularly when delay may open the way for exchange floor members and others to exploit an informational advantage that arises not from their greater investment or trading acumen but merely from their privileged presence on the physical trading floor.

We think an unrestricted opt out would be needed under all market conditions reasonably foreseeable.[4] We note in addition that an opt out clearly is needed if the alternative would be to tie all market participants to the response times of a slow market. That alternative would be to slow the markets down to the lowest common denominator and to remove the competitive advantages the electronic markets have in attracting order flow. It would not promote inter-market competition and it would not advance the public interest or the protection of investors.

We note that the Commission's public hearing in April, and the comments that the Commission has received on its rule proposal, reflect wide disagreement over how to define a "fast" or "automated" market. We offer no regulatory definition. Rather, we believe that the market itself will supply the answers if the government simply ensures that pricing data — quotations and last sales — are available to all market participants in a timely fashion and if ready access to the prices is assured.

If the markets are left free to compete, we envision that a fast market will likely be one where (i) the only orders that are executable are publicly disclosed and accessible, (ii) all executable orders are executed automatically in accordance with their published terms without even momentary delay, and (iii) after automatic execution, confirmations or execution reports are immediately transmitted to investors or their agents and the market center's published quotations are immediately updated. These are not the conditions we face today, however, and it is doubtful that they would come into being if the trade-through rule were adopted.[5]

---

4 We take note of press reports indicating that the NYSE may be willing to allow investors to sweep the specialist's book electronically up to some number of ticks away from the NBBO. *See* "NYSE's Automatic Transition," Wall St. J. June 22, 2004 at C1. No market should be deemed fast unless all limit orders (by definition, orders that specify prices and amounts at which a willing investor has already committed to trade) may be accessed automatically and contemporaneously be a willing counterparty.

5 We understand that the NYSE is seeking to persuade the Commission to loosen its definition of a "fast market" for purposes of the trade-through rule to allow the NYSE to freeze its automatic execution facilities to enable its floor members to intercept and interact with investor order flow. *See,* "Big Board, SEC Talks, The Other Market Debate," Securities Industry News (May 17, 2004); *see also,* "NYSE Trading Plan Finds Favor with SEC, New York Post Reports" (June 8, 2004), available on Bloomberg Professional Service under NI SEC and "NYSE's Automatic Transition," Wall St. J. June 22, 2004 at C1. We have not seen in the Commission's public files any memoranda documenting such meetings or other communications with the NYSE other than a memorandum dated May 20, 2004, filed June 3, 2004, summarizing a meeting with the NYSE on March 31, 2004, and a memorandum dated June 18, 2004

(Continued footnote)

A governmental floor on speed is very likely to become the ceiling because a mandatory trade-through rule will not reward innovations in technology or services among different markets. We respectfully suggest that, rather than determining how fast is fast enough, the Commission should do what is necessary to ensure there is real competitive pressure on market centers to embrace technology rather than resist it.[6]

Beyond the question of speed is the need of investors to select markets of execution on the basis of other, significant factors they themselves value, all of which contribute to obtaining the best all-in price for trades. As Scott DeSano, head of our Equity Trading Desk, noted in our April Testimony:

> "We understand that market centers with a vested interest in preserving their market share of trading volume may contend that support for an opt-out provision is antithetical to the goal of best execution. The argument is that by

---

(Footnote continued)

concerning a meeting held June 17, 2004 . *See* Memoranda from the Division of Market Regulation (File names s71004-212.pdf and nyse061704.pdf) at http://www.sec.gov/rules/proposed.

Each of these memoranda fails to provide the public with details adequate to gain any informed understanding of the discussions being held between the staff and the NYSE regarding the SEC's proposed rulemaking. We respectfully suggest to the Commission that this rulemaking and any meetings the Commission or its staff have with the NYSE or other parties relate to valuable franchises that are being awarded or protected and that the substance of any communication, not just the fact that it occurred, must be disclosed in memoranda placed in the public file. *See, Home Box Office v. Federal Commun. Comm'n*, 567 F.2d 9, 57 (D.C. Cir.), *cert. denied*, 434 U.S. 829, *reh'g denied*, 434 U.S. 988 (1977) ("Once a notice of proposed rulemaking has been issued, . . . any agency official or employee who is or may reasonably be expected to be involved in the decisional process of the rulemaking proceeding, should 'refus[e] to discuss matters relating to the disposition of a [rulemaking proceeding] with any interested private party, or an attorney or agent for any such party, prior to the [agency's] decision * * *,' Executive Order 11920, § 4, *supra*, at 1041. If *ex parte* contacts nonetheless occur, we believe that any written document or a summary of any oral communication must be placed in the public file established for each rulemaking docket immediately after the communication is received so that interested parties may comment thereon. Compare Executive Order 11920, § 5, supra" [footnote omitted].). *See also,* Securities Acts Amendments of 1975, Report of the Senate Comm. on Banking, Housing, and Urban Affairs to Accompany S. 249, 94th Cong., 1st Sess. 29-30 (1975).

6 We also share the concern about unintended consequences mentioned by Gerald Putnam at the Commission's April 21 hearings on Regulation NMS that "smart" order-routing technology likely will malfunction if fast markets are prohibited from trading through other fast markets. *See* Hearing Re: Proposed Regulation NMS, (April 21, 2004) in File No. S7-10-04 at 53-54, available at: http://www.sec.gov/spotlight/regnms/nmstrans042104.txt and the discussion of the "intermarket sweep order" in Securities Exchange Act Release No. 49749 (May 20, 2004) in text at 32-33. The fact that this problem would, or could, result from the proposed trade-through rule demonstrates that the rule would micromanage a process that would best be left to investor choice and discretion.

supporting a rule that allows us to choose among competing market centers, we somehow favor speed or certainty of execution *at the expense of best price*. We categorically reject this contention. Speaking for Fidelity, let me make one thing clear: In seeking best execution in trades for our funds we have one objective — and only one objective — in mind. That objective is to obtain the best overall price for our funds' trades. We view speed and certainty of execution as means to an end, and that end is overall best price."

"Experience has taught us a very clear lesson. Given the dynamics of our trading markets and the rapid and sudden shifts in stock prices, the overall best price for the purchase or sale of stocks for our funds often depends upon our ability to lock in a price at a given moment for all or a significant part of our trade. If we are compelled, against our better judgment, to break up our orders and execute them over an extended period of time, in many cases this will lead to inferior all-in prices for our funds. An opt-out provision to the trade-through rule will not subordinate best price to certainty or speed of execution. We value certainty and speed of execution precisely because these factors play an indispensable role in obtaining best price for our funds' trades."

As we noted above, best all-in pricing must also take into account the market data fees and transactional fees charged by each market center. Investors, especially those acting as fiduciaries, must be free to take these costs into account, as well as other factors more difficult to quantify on a trade-by-trade basis, that bear upon the quality of market regulation prevailing in a given market center. All the fees may be "reasonable," but some may be more reasonable than others. In a market where there are 100 price points per dollar, access fees and market information fees may be highly relevant to the all-in cost of a trade. Also crucial to informed order-routing decisions is the need to preserve the confidentiality of our trading intentions, in terms of the size of our trades and their direction.

Experience has taught us that the ability of our funds to obtain best execution is seriously undermined in any market that does not allow for immediate executions against limit orders at different price levels — starting with the best bid or offer on the book. A market, such as the NYSE, that allows for immediate execution against only the very top of its limit order book, and obstructs contemporaneous executions at all other prices at which willing buyers and sellers have committed to trade does not, in our view, qualify as a fast market. A trade-through rule that ignores this economic reality will serve only to reinforce pricing inefficiencies and impede best execution on any market, such as the NYSE, that seeks to prevent or obstruct a willing buyer or seller from "sweeping the book" even when the buyer or seller is willing to give the best price to all orders that are swept.

Some who oppose an opt-out right suggest that investment managers would invoke the opt-out right to the detriment of the funds or accounts they manage. This contention is baseless. The Commission should draw comfort, we believe, from the natural, competitive incentive of investors, including fiduciaries, to get the best prices they can. As the Commission knows, fiduciary duty commands an investment manager to seek the most advantageous terms reasonably available under the circumstances for its clients' orders.[7] Whether because of fiduciary duty in the case of investment managers or economic self-interest in the case of proprietary traders, those who transact in the public market have a strong interest in maximizing investment returns and they correctly view execution as an important element of overall performance.

At Fidelity, we have no reason or incentive to by-pass readily accessible limit orders in any market where executions are certain and immediate. In seeking best execution of large orders, we seek the best overall execution, that is, best overall price. Walking the market up or down over several minutes or even seconds, if the ability to sweep the limit order book is denied, seriously impairs our ability to obtain the best execution for our funds. Often, liquidity at prices above or below the NBBO will fade away if we have to work our way, over the course of several seconds or minutes, above or below the NBBO. That fading away occurs as market professionals see us taking up liquidity at the prices nearer to the NBBO and then either compete with us for liquidity at the more distant prices or withdraw orders they have placed at those prices only to put them further away from what had been the NBBO. All of this suggests the markets are sufficiently complex that a one-size-fits-all trade-through rule is too limiting unless market participants are permitted to opt out of the rule when their fiduciary duty or economic self-interest tells them they should.

IV. Reforming the NYSE's Intra-Market Trading Rules Governing Limit Orders Should Precede Any Inter-Market Trade-Through Rule.

Those who advocate an inter-market trade-through rule presuppose that such a rule will strengthen protection for limit orders and thereby encourage more investors to place limit orders in market centers competing with the NYSE. That supposition, however, overlooks trading rules ***within*** the NYSE's own market which deny time priority to limit orders against later orders from the floor or the specialist at the same price.

For example, under the NYSE's rules, a limit order entered at 10:30 a.m. to buy 500 shares at $20 per share does not have time priority over a bid to buy 500 shares from a floor broker first made at 2:30 in the afternoon at the same price. If a sell order for 500 shares at $20 arrives at the NYSE at 2:30, the investor who has entered the limit order four hours earlier is not entitled to buy all 500 shares. She will receive only 250 shares and the floor broker will be allowed to buy the other 250 shares.

It is widely assumed that the NYSE's trading market is built upon strict price and time priority for all orders. This is simply not the case. Rather, limit orders on the NYSE's

---

[7] *See,* Release in text following n.69.

specialist book are given second-class status under the NYSE's "auction" rules. If the Commission seeks to encourage the placing of limit orders by investors, including institutional investors, the most effective way to do so would be to reform the trading rules of the NYSE to provide ***within the NYSE's own market*** time priority of limit orders over later bids and offers by floor brokers and specialists at the same price.[8]

It is clear to us that an inter-market trade-through rule will not encourage investors to place limit orders either on the NYSE or on markets seeking to compete with the NYSE. As noted earlier, in the absence of inter-market time priority, the NYSE specialist effectively has a right of first refusal before any order is sent from the NYSE to another market which was first in time to quote a superior bid or offer. Also, as noted above, the trade-through rule leaves untouched rules of markets, such as the NYSE, that deny *intra-market* time priority for limit orders over later bids and offers at the same price from the trading crowd and deny a willing buyer or seller the ability to "sweep" the limit order book, even when the buyer or seller is willing to sweep all limit orders at the same, most favorable price. Finally, limit orders are not protected against "pennying" by specialists, who take advantage of their physical presence on the floor. For every "penny jumping" trade by a specialist that "price improves" one side of a trade, another investor, whose limit order has been bypassed, has been disadvantaged.

Nasdaq has never been subject to a trade-through rule and we are not aware of any significant incidents of trade-throughs in that market. While Nasdaq technology has had some shortcomings, Nasdaq is basically an automated market and, in general, there is little incentive to trade through the competing market makers' quoted prices.

The efficiencies introduced by the ECNs have driven all the Nasdaq market makers to increase their speed of response. The effects have been salutary. Trading in Nasdaq's fast market is driven by competition for order flow among market makers and the best execution obligation among order-entry firms. Those two factors have combined to provide greater benefits for investors in Nasdaq securities than the ITS trade-through rule provides for investors in NYSE-listed securities. In the absence of a trade-through rule, Nasdaq has operated efficiently and well.

---

8 Under NYSE Rule 72 (III), for example, a "new" auction is deemed to occur after every trade, thereby negating the time priority that would otherwise attach to limit orders entered on the specialist's book over later bids or offers that are made at the same price in the trading crowd. That rule provides as follows:

> **III. "Sale Clears the Floor"—**Following a sale, all bids and offers previously entered are deemed to be re-entered and are on parity with each other…

The successful prosecution of Nasdaq market makers for collusive price fixing, together with the Commission's adoption of the Order Execution Rules, Exchange Act Rules 11Ac1-1 and 11Ac1-4, did much to promote greater competition in Nasdaq market making and to eliminate fraud. We expect that in the exchange markets as well, limit orders would be best protected by vigilance against fraudulent conduct and increased inter-market competition in market making. The Commission's proposed trade-through rule will not contribute to best execution or to greater competition.

V. Cost of Compliance

We respectfully suggest the proposed trade-through rule is much too expensive to implement, particularly since the costs it imposes will likely be borne ultimately by the investors themselves. By the Commission's own estimates, the cost of implementation would run into hundreds of millions of dollars, as reflected in the tables attached as Attachment B, drawn from the data in the Release.

* * * * * * *

These several considerations lead us to recommend that the Commission not adopt the proposed trade-through rule but that, if it does, it should retain in the rule the unrestricted opt-out right. We doubt very much any untoward results would occur from retention of the unrestricted opt out. What will occur would be a healthy increase in inter-market competition, which would do more to protect investors and advance the public interest than any trade-through rule would do.

We appreciate the opportunity to present our views to the Commission. If members of the Commission or the staff wish to discuss our comments, please call either me (617-563-7000) or our counsel, Roger D. Blanc (212-728-8206).

Respectfully submitted,

Eric D. Roiter

Eric D. Roiter

Attachment

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
Heather Seidel, Esq., Attorney Fellow
Division of Market Regulation
Jennifer Colihan, Esq., Special Counsel
Division of Market Regulation
Paul Roye, Esq., Director
Division of Investment Management
Giovanni P. Prezioso, Esq., General Counsel
Mike Eisenberg, Esq., Deputy General Counsel

ATTACHMENT A

April 9, 2004

TESTIMONY OF SCOTT DESANO ON BEHALF OF FIDELITY MANAGEMENT AND RESEARCH COMPANY AT HEARINGS BEFORE THE SECURITIES AND EXCHANGE COMMISSION ON PROPOSED REGULATION NMS

File No. S7-10-04

April 21, 2004

Good morning. My name is Scott Desano. I head the Equity Trading Desk at Fidelity Management and Research Company. As of March 31, 2004, Fidelity acted as the investment manager of over 200 equity mutual funds registered under the Investment Company Act of 1940, representing aggregate equity assets of over $575 billion. As a fiduciary for the Fidelity Funds, we are an active and substantial participant in the secondary equity trading markets in this country. Our funds have a vital interest in efficient, transparent, reliable and fair trading markets — markets where order flow is earned through innovation, service and competition.

With decimalization, and the dramatic growth of electronic trading systems and alternative market centers, the Commission's proposals come at a crucial stage in the evolution of our equity trading markets. Given the importance that we attach to the role of open and free competition in shaping our nation's equity markets, we commend the Commission for including in proposed Regulation NMS a provision that will afford informed investors the freedom to opt-out of the trade-through rule. The flexibility conferred by the opt-out provision is crucial to an investment manager such as Fidelity because it will preserve our ability to perform our fiduciary duty to its fullest extent. That duty is to use our independent judgment solely in pursuit of the best executions available to the mutual funds under our management. To carry out our fiduciary responsibility, it is essential that we retain the ability to exercise our judgment in deciding how to size the orders we present for execution, how much pricing and timing discretion to give the brokers that serve our funds, and whether to give those brokers the power to seek liquidity without regard to the trade-through rule.

We understand that market centers with a vested interest in preserving their market share of trading volume may contend that support for an opt-out provision is antithetical to the goal of best execution. The argument is that by supporting a rule that allows us to choose among competing market centers, we somehow favor speed or certainty of execution *at the expense of best price*. We categorically reject this contention. Speaking for Fidelity, let me make one thing clear: In seeking best execution in trades for our funds we have one objective — and only one objective — in mind. That objective is to obtain the best overall price for our funds' trades. We view speed and certainty of execution as means to an end, and that end is overall best price.

Experience has taught us a very clear lesson. Given the dynamics of our trading markets and the rapid and sudden shifts in stock prices, the overall best price for the purchase or sale of stocks for our funds often depends upon our ability to lock in a price at a given moment for all or a significant part of our trade. If we are compelled, against our better judgment, to break up our orders and execute them over an extended period of time, in many cases this will lead to inferior all-in prices for our funds. An opt-out provision to the trade-through rule will not subordinate best price to certainty or speed of execution. We value certainty and speed of execution precisely because these factors play an indispensable role in obtaining best price for our funds' trades.

To serve our fund investors who have entrusted their money to us, we and the brokers we employ need to have the full range of discretion in executing orders. We, as is true for all other fiduciaries, should not be constrained by a trade-through rule which would compel, without exception, that we walk the market up or down for every stock our funds wish to purchase or sell when, at least in certain instances (especially in rapidly shifting markets experiencing sharply fluctuating levels of liquidity), fiduciary judgment tells us that such a course would be unwise and would disadvantage our funds.

Those who oppose the flexibility of an opt-out provision for fiduciaries contend that the ability of mutual funds and other institutional investors to obtain best execution should be curtailed in the name of fairness to third parties in the marketplace, especially retail investors, even when this will result in an inferior overall price for mutual funds and other institutional investors. Our answer is that institutional investors should be allowed to do what is best for the investors on whose behalf they act as fiduciaries, without having to provide a subsidy to others. If the markets are left open and free to compete based upon innovation and service, rather than based upon government-imposed order routing rules, the efficiencies and economic self-interest of investors, large and small, will naturally lead to the evolution of a national market system that will redound to the benefit of all market participants.

We understand that a more limited argument against an opt-out provision holds that a truly "fast" market should not be traded through by another fast market. We believe it is unwise, as a matter of public policy, for the Commission to condition the flexibility afforded by an opt-out provision under current circumstances, even when a market is presumed, for regulatory purposes, to be "fast."

First, a market deemed "fast" at a point in time coinciding with a Commission rule may not be "fast" in the future and, in any event, may not always be "fast" when the time it takes to route orders to and from the market via existing linkages is taken into account. If a market can instantaneously (i) respond to an order at the time of order entry and (ii) confirm an execution or re-route the order (or a portion thereof) to another market center in another microsecond to the market showing the next best price, perhaps this would satisfactorily address the issue of speed. It is not today's reality, however.

Perhaps the more important reason to preserve opt-out flexibility even among fast markets is that fiduciary duty and economic self-interest of market participants counsel against the need for government-imposed trading rules. At the least, the Commission should give the market an opportunity to operate without the constraints of inter-market order routing requirements before imposing a rigid trade-through rule applicable to all market participants under all circumstances. If there really is no incentive to avoid fast markets or to select among them, a rule is not needed to require an institutional investor, or a broker acting on its behalf, to act in its economic self-interest.

At Fidelity, achieving the best possible performance for our funds' investors is the overarching goal. We continually seek to evaluate all aspects of our operations, from research and stock picking, to order generation and execution. We are not satisfied with "good enough" in executing trades — good enough is not our objective for our fund shareholders. We seek to beat the average execution and we charge our brokers with the responsibility to do all they can to deliver that result. For that reason, we wish to have maximum flexibility in making order-routing decisions and not to be fettered by order routing rules that will prevent us from doing our utmost for our investors.

* * *

We appreciate the opportunity to give our comments to the Commission on these important matters. We hope our views will be helpful to the commission and its staff as they continue to weigh these issues. I would be pleased to answer any questions you may have.

ATTACHMENT B

COSTS OF COMPLIANCE WITH COMMISSION TRADE-THROUGH RULE

The Commission's own preliminary estimates of the securities industry's costs of compliance with the proposed trade-through rule run into the hundreds of millions of dollars and include the following estimated start-up costs of compliance:

Start-up Costs	Projected Amount
One-time cost to SROs and non-SRO order-execution facilities to establish compliance policies and procedures.	$145.5 million
One-time cost to SROs and non-SRO order-execution facilities resulting from outsourced legal work re compliance policies and procedures.	101.7 million
One-time cost to broker-dealers of systems changes for disclosure to investors re opting out.	83.9 million
One-time capital cost resulting from outsourced legal work re disclosure requirement.	16.2 million
One-time cost to broker-dealers to make system changes needed to provide NBBO to customers opting out of trade-through rule	193.6 million
TOTAL ONE-TIME, START-UP COSTS OF COMPLIANCE:	$540.9 million

Source: Release No. 34-49325, in text accompanying nn.104-116.

Perhaps even more startling are the Commission's preliminary estimates of *annual* costs of continuing compliance with the proposed trade-through rule:

Ongoing Cost Item	Projected Amount
Ongoing costs per annum for SRO and non-SRO order-execution facilities to ensure that their polices and procedures are up-to-date and remain in compliance with the Commission's rule.	$75.6 million
Ongoing costs per annum to monitor systems and conduct systems maintenance for provision of NBBO to customers	148.2 million
TOTAL ANNUAL, ONGOING COSTS OF COMPLIANCE:	$223.8 million

Source: Release No. 34-49325, in text accompanying nn.104-116.