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What is past is prologue.
--William Shakepeare

One thing seems very clear from reading the comments made on proposed Regulation NMS: Everyone wants best price; the proposed opt-out provisions are a second-best solution.

What the Commission should do is to establish as an objective (to be achieved as rapidly as possible) that *all* bids and offers be instantly visible and accessible in the national market system, and that "best execution" will be inherent within the system.

The most recent comment letter sent to the Commission, written by George U. Sauter, the Managing Director of The Vanguard Group, Inc., on July 14th, 2004, says it well:

"Some observers claim that investors are best served by obtaining the best possible price, while others advocate speed and certainty of execution. We believe that both of these are important considerations in achieving best execution. There is no need to debate whether best price or speed and certainty is better. Investors require both, and both are provided by a perfectly liquid market.

"Given this fundamental objective, market structure rules should be designed with the simple goal of providing maximum liquidity. This is achieved by creating rules that entice investors, market makers and other market participants to place limit orders on an order book. And, certainly, any rules that disincent limit orders are contrary to this objective.

"We support the Commission's proposed uniform trade-through rule, as it would further the goal of promoting total market liquidity. The requirement that trading occur at the national best bid and offer (NBBO) ensures that limit orders have standing in the marketplace. However, ***we would note that the current linkage between markets and the nature of manual markets inhibits the efficient execution of trades.*** [Emphasis added]

"If there were only one marketplace, or a centralization of the marketplace in a Central Limit Order Book (CLOB), then there would be no need for a trade-through rule. [Emphasis added.]

"However, critics of the trade-through rule point out that often those trades that must be forwarded to a manual exchange that, in this example, established the NBBO are not completed in volatile markets because of the time required by the manual market or the time required to transmit the order. This delay can result in unfilled orders as the market moves away. As a result, an immediate execution outside the NBBO in another market may actually be superior to such an unfilled trade.

"We have certainly experienced this in our trading. Nevertheless, we do not believe the trade-through rule is the cause of the problem. Instead, ***we believe the antiquated linkages between markets and the slower execution of manual markets are the culprits. Addressing these issues would be a better approach to solving trading delays and failure of execution.*** [Emphasis added.]

"Furthermore, we worry that completely abandoning the trade-through rule could produce some very unfavorable consequences, namely the total disincentive to provide liquidity---i.e., place limit orders. If executions outside of the NBBO proliferate, the investor that placed the limit order at the NBBO is disadvantaged by not receiving an execution. Why would an investor place subsequent limit orders when they can simply be circumvented? Of course, the order taking the liquidity is immediately filled in a fashion that is satisfactory to the trader, but why should the order taking liquidity out of the market be favored over the order contributing to liquidity in the marketplace? This is a short-term solution to satisfy market orders. It could significantly negatively impact liquidity, and the ability to fill market orders efficiently, in the future.

"We prefer a system of market linkages that provides immediate access to the NBBO, essentially functioning as a national CLOB. Opponents of this concept claim that there would be no incentive for innovation. However, we observe today that marketplaces compete even when they do not have the best bid or offer. ***They route to the best bid or offer on another market and attract orders by competing on price (commissions), better service and trading enhancements, as they become a portal into a larger market system. Innovations, such as a reserve book or other service, still provide a competitive advantage.****"* [Emphasis added.]

Supporting Vanguard's position used to be the Commission:

SECURITIES EXCHANGE ACT OF 1934
Release No. 12159
File No. S7-619
March 2, 1976

The Release stated (in part):

"The Commission believes that there is a need for further modernization and improvement of our securities markets, not only for the purpose of utilizing new data processing and communication techniques, but also to insure economically efficient execution of securities transactions and fair competition among brokers and dealers and among various securities markets which either directly compete with each other or have the potential for such competition. Existing exchange mechanisms for the storage and execution of limited price orders appear to be in need of modification to meet the requirements of member firms and investors for expeditious handling of order flow in the context of a national market system, as well as to cope with an increasing volume of securities transactions (such as that experienced in recent weeks). Further, ***existing limit***

order mechanisms are unable to provide nationwide limit order protection and thus cannot always provide the degree of protection for limit orders which hopefully could be furnished by a composite book. *Finally, a composite book appears to be well suited to assuring an opportunity for public orders to meet without the participation of a dealer.* [Emphasis added.]

"The Commission concluded in its release adopting Rule 19c-1 that the answer to the problem of providing adequate protection for public limit orders is not to maintain existing rules and practices, which provide only imperfect protection and have certain undesirable anticompetitive effects, but rather to use the advanced technology now available to provide for a computerized central limit order repository -- a composite book. [Emphasis added.]

"A composite book would permit the effective integration of existing market makers (both exchange and third market); in addition, ***such a book would provide brokers and dealers with an efficient and practical means by which all limit orders, regardless of origin, can be protected on a national basis. Once a composite book is in place, the Commission expects that all brokers and dealers should be required to satisfy orders on that book prior to execution of a transaction at an inferior (and, perhaps, at an equal) price in any market."*** [Emphasis added.]

I agree with both Mr. Sauter and the Commission in these opinions, and urge the Commission to facilitate the building of a modern national market system they described so well in 1976.

Very truly yours,

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