THE BANK OF NEW YORK
NEW YORK'S FIRST BANK – FOUNDED 1784 BY ALEXANDER HAMILTON



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JOSEPH M. VELLI
SENIOR EXECUTIVE VICE PRESIDENT

June 30, 2004

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Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

**Re: Proposed Rule: Regulation NMS (File No. S7-10-04)**

Dear Mr. Katz:

The Bank of New York[1] ("BNY") appreciates the opportunity to comment on the Commission's proposed Regulation NMS. BNY strongly supports the Commission's goal of further strengthening the National Market System. In large part, we agree with the Commission's proposals to do so. We support a uniform trade-through rule, although we believe an opt-out provision would hamper the Commission's efforts to enhance transparency and liquidity in the national market system. We also agree with the Commission's proposals that encourage fair access to the best prices displayed by market centers, including the reduction of access fees. Finally, we believe the proposal to ban sub-penny quoting in most stocks will promote market efficiency and prevent professional traders from unfairly taking advantage of legitimate trading interest.

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1 The Bank of New York is the oldest bank in the United States. It was founded in 1784 by Alexander Hamilton and was the first corporate stock to be traded on the New York Stock Exchange in 1792. Together with its parent company, The Bank of New York Company, Inc., The Bank of New York has a distinguished history of serving clients around the world through its five primary businesses: Securities Servicing and Global Payment Services, Private Client Services and Asset Management, Corporate Banking, Global Market Services, and Retail Banking. The Bank of New York Company, Inc. is a global leader in securities management services operating in more than 100 markets and servicing issuers, institutional investors and broker-dealers. The Company plays an integral role in the infrastructure of the capital markets safekeeping over $8 trillion in investors assets. Through its nearly 23,000 employees, the Company provides quality solutions for global corporations, financial institutions, asset managers, governments, non-profit organizations, and individuals.

Over the past several years, The Bank of New York has greatly enhanced its brokerage and clearing capabilities through both targeted acquisitions and internal growth, and grouped these businesses in BNY Securities Group. This focused strategy is part of The Bank's continued efforts to provide clients with the resources and highly personalized service required to succeed in the investment marketplace. BNY Securities Group's core business lines include institutional agency brokerage, clearing and financial services outsourcing businesses. The broker-dealers within the Group have a total of 23 NYSE seats, over 1,300 institutional clients and over 1,000 correspondent clearing clients. We believe that, collectively, we are the largest institutional agency brokerage in the industry and, through Pershing LLC, the largest correspondent clearing organization in the industry.

## 1. Trade-Throughs

We believe the principle of price protection is fundamental to a fair and efficient national market system. A uniform trade-through rule would prevent the execution of an order in a National Market System security at a price inferior to the national best bid or offer ("NBBO") for that security. All investors, large and small, would benefit from a rule that would ensure that their orders are not by-passed in favor of another.

We agree with the Commission that a uniform trade-through rule would encourage the use of displayed limit orders and aggressive quotation. In the market for Nasdaq securities, for example, many investors are reluctant to show their full trading interest for fear of having others use that information to their detriment. A uniform trade-through rule would incentivize these investors to display their interest, knowing their order must be filled before the next-priced order. Accordingly, a well-formulated trade-through rule will promote transparency and liquidity in the national market system.

We generally agree with the Commission's proposed definitions of "automated order execution facility" and "non-automated order execution facility." We believe, however, that such definitions should be applied to quotes rather than markets generally. Among other things, identifying specific quotes eligible for trade-through protection furthers the Commission's objective of promoting transparent liquidity. Market participants should receive the benefits of the rule only when their quotations are transparent, accessible and executable. The Commission should adopt objective, quantifiable criteria to establish whether a particular quote qualifies as "fast."

Some markets might wish to give their participants the option of having certain of their quotes deemed "fast" and others not. For example, an institutional investor interested in executing a large block trade might prefer the price discovery mechanism of an auction market. The Commission's rules should not force markets and market participants to make a Hobbesian choice between a fast execution at the current price and a slower execution using a process which the participant or investor believes will ultimately result in a better price. Of course, the Commission should set an effective date for Regulation NMS that would allow market centers wishing to have their quotes qualify as "fast" a reasonable period of time to adapt their systems.

The best bid and offer of each market center – including market makers and alternative trading systems ("ATSs") – should be protected by the trade-through rule. Any market center whose quotations are accessible, executable and required to be displayed in the consolidated quote should be entitled to the protections of the rule. To do otherwise risks stifling innovation and competition between market venues. The trade-through rule should offer primary protection to automated quotes, orders that are executable through an immediate electronic computer-to-computer communication with no manual intervention.

The Commission's proposal of a graduated exemption from the trade-through rule, which would permit trade-throughs up to $.05 depending on the price of the stock being traded, is too complicated and would be too costly to implement. Although price protection is of paramount importance to investors, speed and certainty of execution are also increasingly important to many investors. The Commission should encourage markets to provide speed and certainty by adopting a trade-through rule that prohibits an automated quote from trading through another automated quote. We agree that slow quotes must bear the risk of having their quotes traded through. The Commission's proposal of a graduated exemption, however, is too complicated and would be too costly to implement. We support a single cap of $.05 per share, market participants should be able to trade through slow quotes up to $.05 per share.

We object to the proposed opt-out exception to the trade-through rule.[2] An opt-out exception would permit market participants to by-pass the legitimate displayed trading interest of those who have not opted out. This unfairness is precisely the reason the Commission should adopt the uniform trade-through rule. The opt-out exception would create an un-level playing field between retail and professional investors, reduce transparency and liquidity, and undermine the benefits accruing from inter-market price protection. Among the supposed benefits of the opt-out exception is the incentive it would provide to non-automated markets to become automated. We believe the proposed exception for non-automated order execution facilities will provide ample incentive to non-automated markets to improve speed and efficiency. We do not see the opt-out exception as a viable short- or long-term solution. Accordingly, the Commission should not adopt the opt-out exception.

We agree that some types of transactions do not require trade-through protection. For example, orders that are not based on the current market price for the security (e.g., volume weighted average price transactions or program trades based on basket pricing) should not be subject to the trade-through rule. Additionally, "intermarket sweep orders," by which an execution facility routes an order to execute against a better-priced order displayed on another market at the same time as or prior to executing the remaining balance on its own market, should be exempt from the application of the trade-through rule. Some participants also call for a block exception. As discussed above, we also would support a block exception from the de minimis exemption (if one were adopted), which would permit market participants to execute without regard to any better-priced non-automated quotes.

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2 If the Commission were to promulgate an opt-out exception, however, it should be mindful of the considerable costs to comply with a trade-by-trade exception. For example, Regulation NMS as proposed would require broker-dealers to include in the Rule 10b-10 confirmation for customers that opt-out the NBBO at the time of execution. We believe the industry-wide cost of systems changes necessary to comply with this requirement would far exceed the benefit to those investors who will make an informed choice to opt-out.

**2. Inter-Market Access**

We encourage the Commission to sponsor the development of strong unbiased linkages between all market centers. A national market of robust linkages that provide fair access, certainty of execution and fast market speeds would allow our markets to remain the standard-setters in fairness as well as technology. In addition, we support the Commission's proposal to reduce access fees to a de minimis amount. The Commission's proposal would allow such venues as alternative trading systems to continue to flourish, while providing other market participants with a certainty that the quoted price, essentially, is the price they will pay. Moreover, permitting market makers and order entry firms to receive such fees will further encourage such participants to provide liquidity to the market. Coupled with Regulation NMS's proposal on locked and crossed markets, the Commission's access fee proposal will promote fairness and enhance the national market system.

**3. Sub-Penny Quoting**

BNY supports the proposed ban on sub-penny quoting.[3] Allowing market centers to quote in sub-penny increments encourages gaming. Under the guise of price improvement, professional traders step in front of existing limit orders at minimal risk, discouraging investors from placing those limit orders. As the Commission has already noted, decimal pricing has already had a negative impact on market depth and transparency. Sub-penny quoting would only exacerbate the problem.

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We appreciate your consideration of BNY's positions. Please contact the undersigned if you would like further information.

Very truly yours,

Joseph M. Velli

cc: Commissioner Paul S. Atkins
Commissioner Roel C. Campos
Commissioner Cynthia A. Glassman
Commissioner Harvey J. Goldschmid
Annette L. Nazareth
Robert L.D. Colby

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[3] Indeed, we would support an increase in the minimum quotation variation to $.05, at least in stocks priced $5.00 or more. We question whether investors truly have benefited from decimal pricing, for it is clear that liquidity and transparency have suffered.