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

RE: File No. S7-10-04

Dear Mr. Katz:

These complex proposals represent a major effort by the Commission staff to create a new regulatory structure for the national market system. Anyone who has devoted time to thinking about this issue has to be impressed by the intellectual energy devoted to proposing these reforms.

I offer these comments on that part of proposed Regulation NMS which amends the existing "trade through" rule. Before making specific comments, I have a preliminary observation on the concept of competition among and between markets - the concept that underpins this propoal. Over many years the Commission has employed this concept to encourage the development of regional exchanges and alternative markets based on the premise that competitive markets improve liquidity, lower transaction costs and improve executions. As far back as 1963, the Special Study of Securities Markets devoted an entire chapter to this concept and recommended that the Commission take regulatory steps to encourage this form of competition. When it adopted the Securities Act Amendments of 1975, the Congress went further by stating that fair competition among and between markets should be one of the guiding principles of the NMS.

An unstated premise behind encouraging competing market centers is that the most powerful of these centers, the NYSE, must be regulated by competition and that any advantages of centralizing public trading in an agency oriented market are trumped by the need to restrain this monopoly in the trading of securities of American's most valuable companies.

The Commission should ask why has the NYSE remained the dominant equities market for over two centuries during which there have been enormous changes in technology, investor profiles and trading strategies and styles. In my view, a centralized agency market is a natural monopoly where "liquidity tends to centralize by providing the narrowest bid/offer spread at volume" to use Chairman Greenspan's words. This concentration of liquidity becomes self-reinforcing, unless restrained by government policy, as costs can be spread over higher volume which, in turn, attracts more order flow to the lower cost market.

Annette Nazoveth, Director of the Division of Market Regulation, has summed up the essential difference between an agency and a dealer market. "The Commission has heretofore always required exchanges to have a limit order book in which better priced orders take precedence. This is inconsistent with the NASDAQ model in which each dealer can interact exclusively with its own order flow while ignoring the book." In an agency market, it is competition among public orders that produces the best bid or offer, unlike a dealer market where competition between and among dealers produces the best bid or offer.

It is doubtful that the alternative markets will provide any additional liquidity in listed securities but rather will largely free ride on NYSE quotations - taking on the role of the old regional exchanges whose survival depended upon preferencing and other arrangements. In my view, the history of encouraging competitive market centers illustrates that government is poorly suited to picking winners and losers among market systems.

The Commission should ask these key questions before adopting this proposal:

Will it deprive public investors of liquidity in the central marketplace of the NYSE? Specifically, how will it impact the execution of public limit orders by allowing member firms to by-pass the book? Will it encourage internalization of orders in member firms? Is the Commission, by encouraging the development of alternative markets, setting the stage for a host of subsequent rules in order to make the rule workable? Has the Commission overlooked the principle that competition among public orders in an agency market is fundamentally different from competition among dealer markets?

Is the Commission using regulatory policy to protect the economic interests of market intermediaries ("picking winners and losers")? Moreover, do these intermediaries need protection in light of the fact that they and their institutional customers can fend for themselves? Why should the Commission give these sophisticated parties a regulatory waiver of the fiduciary principle of best execution?

How does the Commission reconcile its objective of strengthening the NYSE as a regulatory institution with a policy that may over the long run weaken that institution? As a matter of national economic policy, has the Commission thought through the consequences for the American economy of weakening its premier trading market? With its reformed governing structure and its new leadership, doesn't it more make sense for the Commission to give the NYSE the opportunity to integrate its automatic execution capability with its floor based auction system?

As Chairman Donaldson has said, the "critical issue is how best to capture the benefits of speed and certainty of execution while maintaining the bedrock principle of assuring that all investors are protected so that their better priced orders are executed." In my view, the NYSE, subject to rigorous Commission oversight, can achieve this goal.

Very truly yours,

Ralph S. Saul

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