

Testimony of Robert Greifeld
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Chairman Shelby, Ranking Member Sarbanes and members of the Committee,
Thank you for inviting me to testify before you today on a subject of great importance to investors. I am here today as a strong and committed advocate for the elimination of the trade-through rule. The trade-through rule today is the primary obstacle to competition amongst our nation's equity markets, and competition is the driving force in making U.S. markets the strongest in the world, the best for investors large and small, and accountable to the public.

On February 26, 2004, the Securities and Exchange Commission (the "SEC" or "Commission") published for public comment Regulation NMS, which proposes to reform the trade-through rule, and includes other critical reforms regarding market access, market data revenue allocation, and sub-penny trading. These proposals are designed to modernize U.S. market structure and increase competition in our markets. Yet, the question remains whether the Commission's actions will result in marginal change or the substantial reform that is necessary if we are to meet the needs of investors and maintain U.S. leadership in the global equity markets.

The complexity of the current rules and the nature of trading securities where practices have grown up over many decades mask a fundamental truth: today electronic trading is best for investors. Importantly, this truth is implicit in the SEC's proposal, which

essentially forces floor-based auction markets to automate and migrate to a NASDAQ model.

One might ask why does the government have to change the rules? The reason is that the business of running a floor-based auction market is currently protected from competition by a set of SEC-mandated rules. These rules, which are relics of our past, have provided an extraordinary dividend to the intermediaries participating in these floor-based markets. The investing public and the industry are eager for change.

In fact, in a recent survey completed by the Tabb Group in April 2004, 71% of all institutional traders interviewed named the “Specialist & NYSE Market Structure” as one of the greatest trading challenges facing them today.¹

Despite the strong views of the investment community that meaningful change is long overdue, a powerful constituency with substantial resources to resist change has grown around these rules. Just as the candle making industry surely opposed Edison by citing job loss and safety risks to consumers, so too the floor exchange participants who benefit from the status quo have lobbied in the name of the individual investor to prevent change. We must see through these tired arguments.

The emergence of electronic trading in the United States has been limited, with only Nasdaq-listed securities enjoying the fairness and efficiencies of electronic trading. Internationally, electronic trading systems are the norm. Moreover, a number of established international exchanges clearly are in the process of launching efforts to

¹ The Tabb Group, April 2004, *Institutional Equity Trading in America: A Buy Side Perspective*, Larry Tabb at page 43.

compete with U.S. markets for listings and eventually for business supremacy in our capital markets. Surely if we do not take this opportunity, European markets are fully prepared to take the lead from the U.S. in providing investors with modern electronic markets. Trade-through reform is an important aspect of American competitiveness, because if we won't compete with one another, we won't be ready to compete with them.

We are at a critical point. Watered-down half measures often do more harm than good by facilitating the "gaming" of the rules. It is just this gaming that has generated so much of the frustration with the current state of affairs and that was the underlying message of many of the witnesses at the SEC's April hearing on Regulation NMS in New York City. The public is ready for and, in fact, invites real change.

The trade-through rule does not protect investors. Competition and rigorous, conflict-free regulation protects investors. Investors who are not shackled by, or can opt out of, the trade-through rule have a choice. The existence of that choice creates competition, whether or not the choice is exercised. Without choice, all investors are trapped in a closed system. With choice, all investors, both institutional and retail alike, are empowered to make the best investment choices.

The fact that most of the world's major equity exchanges are following NASDAQ's competitive electronic model confirms the wisdom of having the right structure and quality. It also underscores the need for stock markets to evolve and innovate.

I. How the Nasdaq Stock Market operates and why repeal of the Trade-Through rule is so important

A. How the Nasdaq Stock Market operates

NASDAQ is the largest U.S. electronic stock market. With approximately 3,300 companies, it lists more companies and, on average, trades more shares per day than any other U.S. market. NASDAQ has built a market that brings buyers and sellers together efficiently and effectively, one that connects investors and capital with industry-leading companies, and champions and seeks to protect the interest of all investors. Investors come to NASDAQ because they get better execution of their trades in a more transparent environment.

NASDAQ has a decentralized structure of many competing market centers linked together – multiple dealers committing capital and competing for orders under the NASDAQ “big tent” which gives investors a healthy and liquid environment.

NASDAQ’s open and electronic trading environment allows an unlimited number of participants to trade a company’s shares. Instead of representation by individual specialists (such as is the case with the NYSE model), over 300 market makers sponsor NASDAQ companies and trade NASDAQ stocks. An average of 20 cover each NASDAQ security, and as many as 100 or more make markets in some securities.

NASDAQ also offers a high level of transparency that helps investors gauge trends and make more informed decisions.

Computerized trading systems lend themselves to open, efficient, and nearly frictionless markets. NASDAQ has been using advanced technology to operate its market for more

than 30 years. By creating the right balance of man and machine, the human factor comes into play, but only where it adds value. The advantages of a technologically advanced market include the ability to continuously lower cost per transaction without sacrificing reliability. This raises the value delivered to investors.

NASDAQ is the home to category-defining companies that are leaders across all areas of business, including technology, retail, communications, financial services, transportation, media and biotechnology. Companies list on the Nasdaq market because they support our model and believe it is the best means for them to access capital – and investors – to nurture and grow their innovative businesses and technologies, and to create new jobs. Nasdaq-listed companies have a committed interest in ensuring their investors get best execution. This means lower execution cost and higher speed, efficiency and reliability are critical. That is another reason why we are so intensely focused on maintaining the quality of the NASDAQ market with the right and best technology and structure for all investors.

B. Why NASDAQ believes repeal of the Trade-Through rule is so important

First, NASDAQ has never had a trade-through rule. Instead, NASDAQ has relied on a combination of vigorous regulation and competitive forces to protect investors. In proposed Regulation NMS, the SEC is proposing to extend the trade-through rule to the NASDAQ market. We have grave concerns about the impact this rule could have on our market, and the SEC has expressed no need for the rule on our market other than that it would promote uniformity of regulation. Critically, the SEC has not analyzed or assessed

the impact of the rule to the NASDAQ market, yet it seems prepared to dramatically alter the way our market works.

With regard to the application of the trade-through rule to NYSE-listed stocks, NASDAQ also has a strong interest. You see, NASDAQ is not just a market where companies list and investors trade those listed companies' stocks. NASDAQ is a trading execution platform for investors to trade all equities, not just those listed on NASDAQ. It comes as a surprise to many to learn that approximately 15% of the volume in NYSE-listed stocks trade today on NASDAQ.

But that number could be much higher. Investor demand for our trading platform is strong, yet the trade-through rule is an enormous impediment to investors wishing to exercise their choice of market as to where they can get the best execution of their trades. I am here today urging the repeal of the trade-through rule because I have customers – investors – who want to use the NASDAQ trading platform, but are prevented from doing so due to the trade-through rule. This rule hurts our business and it hurts investors.

In the next section of the testimony, I will address in more detail NASDAQ's position on the trade-through rule and why its repeal is important to markets and investors.

II. NASDAQ opposes a Trade-Through rule for the trading of Nasdaq-listed securities.

The trade-through rule is unnecessary for NASDAQ securities because the proposed rule's objectives have already been achieved in this market. The SEC itself provides a solid case against a trade-through rule for NASDAQ. At the time proposed Regulation

NMS was released for comment, the Commission stated: “even without a trade-through rule, the NASDAQ market does not appear to lack competitive quoting in the most actively traded securities.”

Statistics derived from Rule 11Ac1-5 data clearly evidence the results of the competitiveness in the NASDAQ market. As the table below demonstrates, when compared to the NYSE, NASDAQ offers investors tighter quoted and effective spreads with greater speed and certainty of execution.² Our belief is that, in fact, there is substantial likelihood that applying the trade-through rule to the NASDAQ market will harm investors.

	EFFECTIVE SPREADS (Cents)	
	NASDAQ	NYSE
S&P 500 Stocks	1.17	1.82
Dow Jones U.S. Large Cap Index Stocks	1.18	1.79
Russell 1000 Stocks	1.37	1.97

A trade-through rule imposed on the NASDAQ market could harm the quality executions and competition that exist in the NASDAQ market. The harm to investors may take many forms, including increasing the cost of trading due to the additional costs of complying with the rule. Whether the SEC adopts an automated market or automated quote approach for the trade-through rule, market participants will be required to make complex and expensive system changes to recognize when a market or quote is “non-automated.” The markets and market participants trading NASDAQ securities will bear a disproportionate amount of these costs because there is no trade-through rule today for

² SEC Rule 11AC1-5 data, January 2004 marketable orders of all sizes under 10,000 shares, provided by Market Systems, Inc. See SEC Release No. 34-43590; File Sy-16-00 (November 17, 2000).

NASDAQ securities. Finally, evidence indicates that these costs are unnecessary because the trade-through rate for NASDAQ listed securities, without a trade-through rule, is lower than for listed securities, which trade under such a rule.

**Observed Trade-Through Rates using Last Sale Data
Apr 1 – 12, 2004**

Detection Rule <i>Before/After</i> <i>(seconds)</i>	NYSE-Listed <i>(Avg 1.95 MM Trades/day)</i>		Nasdaq-Listed <i>(Avg 3.49 MM Trades/day)</i>	
	Trades	Shares	Trades	Shares
0/0	4.2%	10.2%	7.7%	11.5%
5/2	2.0%	6.9%	1.6%	5.1%
10/5	1.5%	5.3%	0.9%	3.5%
25/10	1.0%	3.6%	0.5%	2.0%

In a larger sense, however, the current proposal has a fundamental flaw because it will nullify the improvements the SEC has implemented in the NASDAQ market over the past ten years. During this period, the SEC has adopted a series of rules that use market forces to produce a structure that provides quality executions, freedom of choice, and cost savings to investors. These initiatives include the limit order display rule and Rules 11Ac1-5 and 11Ac1-6.

In adopting the limit order display rule, the SEC went beyond ensuring that limit orders are treated fairly and contribute to quote competition; the SEC created an environment where market forces and competition would flourish to the benefit of investors.

Specifically, the SEC allowed market makers to continue to send limit orders to broker-

dealer matching systems, known as electronic communications networks (“ECNs”), at a time when NASDAQ did not have its own limit order book. The result was that many ECNs entered the market and became the de facto limit order books for NASDAQ.

NASDAQ responded to this competition by creating its own electronic limit order book. Currently, over 65% of NASDAQ trading occurs on these limit order books. While the number of limit order book providers has decreased, the competition among those remaining continues and has led to a dramatic reduction in execution fees. Faster execution times are another result of this competition, as these market participants innovate and improve services to distinguish themselves from their competitors.

With competition firmly established, the SEC then adopted Rules 11Ac1-5 and 11Ac1-6 to assist investors in making informed decisions. Giving consumers accurate information upon which to evaluate competitors also enhances competition. Today, market participants can “shop” when deciding where to send their orders. NASDAQ understands that customers are using the execution quality statistics as benchmarks that their brokers must not only just meet, but also exceed.

Importantly, none of the SEC’s initiatives constrained customer choice as to how their orders could be executed or how they should measure execution quality. For example, the SEC did not choose to mandate a central limit order book that would have limited choices and decreased competition. A trade-through rule has many of the same drawbacks as a central limit order book because of its exclusive focus on displayed price as the benchmark for defining execution quality. The SEC risks undoing a decade’s worth of progress by adopting a trade-through rule for NASDAQ securities.

III. NASDAQ supports repeal of the Trade-Through rule; nonetheless, reform which includes a workable opt-out exception would improve execution quality and competition in the NYSE-listed environment.

A. The Trade-Through rule no longer serves a purpose and should be eliminated.

So that investors can realize the full benefits of a truly competitive market, the SEC should eliminate any trade-through restrictions for NYSE-listed securities. While the market for trading NASDAQ securities is better because of the SEC initiatives previously discussed, the market for trading NYSE-listed securities has been stuck in a time warp and has not seen the same benefits of competition. NASDAQ believes the different results can be traced to one major difference between the markets: the trade-through rule.

The trade-through rule is a vestige of an antiquated, manual, floor-based, single specialist market that has stifled competition in the trading of NYSE-listed securities and does not reward or recognize speed and certainty of execution or other factors investors may consider when measuring best price. The trade-through rule creates a monopoly at the best posted price, a monopoly that favors slow, manual markets whose posted price may not reflect the price available on the floor. In this regard, electronic markets' participation in the listed market has been hobbled.

If the Commission adopts a trade-through rule without an opt-out provision, basic trading choices that exist today will be eliminated, which could increase costs to investors. For example, investors seek to execute orders with minimal price impact. In fact, analyses of trading costs include measurement of market impact – how much did the market move in reaction to the existence of a large order.

Today, investors use many different means to lessen market impact, including utilizing the block-order exemption from the trade-through rule for NYSE securities. Of course, in the NASDAQ market these investors have the greatest degree of flexibility because there is no trade-through restriction. As a result, investors can execute sizable trades immediately with dealers or other investors through crossing mechanisms, without “tipping” the market about the pending large order by being forced to trade with the displayed price. Investors are willing to accept prices that are “away” from the prevailing “best” price because of the certainty and speed they obtain.

B. If the SEC chooses to reform rather than repeal the Trade-Through rule, a workable opt-out provision is critical.

A viable opt-out provision will impose competitive discipline by allowing market participants to avoid a market center that routinely fails to provide timely executions at the price reflected in its quote. However, market participants will still have every incentive to seek the best certain price, and brokers that routinely fail to do so will be subject to disciplinary action and will lose business to competitors.

As proposed by Regulation NMS, however, the opt-out exception may be unworkable. It will frustrate rather than enable freedom of choice for investors and limit rather than promote automated executions. In an unprecedented manner, the opt-out exception imposes burdens on both the investor seeking to opt-out and the broker-dealer handling opt-out orders. Some aspects of the proposal impose the burden on both parties, while other aspects only affect the broker-dealer handling the opt-out order. For example, the need for informed consent on an order-by-order basis imposes a burden on both parties.

The broker-dealer handling the order must provide disclosure each time an order is received, and the entity opting out (e.g., a customer or another broker-dealer) must affirmatively opt out each time it places an order. For some market participants, this exchange of information would be necessary hundreds or thousands of times per day. These exchanges will most certainly delay the execution of orders, while contributing little, if any, investor protection.

The opt-out exception requirement to provide customers the best bid or offer that existed at the time their order was executed is a burden that will be imposed on broker-dealers directly, and possibly on customers indirectly if the costs of complying with this aspect of the rule are passed along to customers. Trading does not occur in a manner that allows each order to be matched easily with a particular execution or quote. In particular, large orders often are placed for multiple accounts, and the executing broker-dealer may not know to which account the trade should be allocated until after the order is fully executed. Broker-dealers will have to recreate the execution history of orders so that they can provide the best quote that existed at the time each portion of an order was executed. To provide this information for each of the thousands of orders executed each day, whether or not the customer wants the information, will impose a significant burden because firms will have no choice but to find some manner of automating the process.

NASDAQ has proposed two modifications that will make the opt-out exception less burdensome, while not diminishing its investor protection elements. First, NASDAQ proposes that broker-dealers be required to disclose the best bid or offer at the time of execution to customers only upon request. This is the same approach the SEC adopted

with respect to payment for order flow and other types of disclosure. Specifically, Rule 10b-10 permits broker-dealers to include a general statement concerning whether payment for order flow was accepted, and to disclose the source and nature of the compensation separately, upon receiving a written request from the customer. Similarly, a broker-dealer must provide its customer the identity of the contra party only after receiving a written request. Adopting this approach for the opt-out exception will require broker-dealers to provide the information to those investors most interested, but not force them to undertake costly system modifications that would be necessary to provide the information to all customers – regardless of whether they want the information.

Second, to satisfy the informed consent obligation, NASDAQ proposes that broker-dealers be permitted to provide an annual statement disclosing the implications of opting out of the trade-through rule. The proposed order-by-order requirement will require the disclosure to be repeated hundreds or perhaps thousands of times per day. Therefore, broker-dealers are likely to provide summary statements about the rule. In contrast, an annual statement could result in a more fulsome disclosure, because it is not being delivered in the midst of a trading day. Requiring an annual statement is consistent with the disclosure obligations concerning margin trading, and is more conservative than the disclosure obligations concerning day trading and trading in penny stocks, which only require one disclosure.

C. NASDAQ does not believe the SEC should define what constitutes a fast market; however, if the SEC does so, it must establish standards that are sufficient and enforceable.

NASDAQ maintains that an effective opt-out exception eliminates the difficult task of defining “fast” because investors will be able to decide for themselves which markets are meeting their needs. No one wants to see an SEC enforcement officer sitting on the floor of an exchange with a stopwatch. The public will be best served by the SEC focusing its resources on matters other than mediating disputes over whether markets are responding to orders within the requisite number of milliseconds.

However, if the SEC believes it is necessary to define “fast” in order to ensure some minimum level of automation, NASDAQ supports a quote-by-quote distinction that requires markets to identify quotes that are slow. A market must identify “slow” quotes on all of its published feeds, and when its best bid-and-offer quotation is sent to the Securities Information Processor (“SIP”) for calculation and dissemination of the National Best Bid/Best Offer (“NBBO”). In addition, the SIP should be required to enhance its distribution of NBBO data by adding a flag to identify a national best bid or offer as “fast” or “slow,” in addition to the market center associated with the bid and/or offer, so that investors will know whether the quote is subject to a trade-through restriction. Without this critical transparency, investors will become confused as to the trade-through treatment of each published quote/order. If investors see the NBBO being traded through, the flag will serve as a visible explanation for this occurrence.

Markets should be required to respond to a party submitting an order within 250 milliseconds. This automated response must indicate that the order was either executed (in full or partially) or rejected.

The automated response requirement also must apply to requests to cancel orders. This requirement will be particularly necessary if markets can alternate between automated and non-automated. For example, a market participant sends its order to a market providing automated access; however, while the order is waiting to execute the market switches to manual execution in order to conduct an auction. Some market participants may not want to participate in a manual auction, but prefer instead to cancel the order and send it to a market that can provide a fast, automatic execution. If markets are not subject to a maximum response time requirement for cancellations, they can hold orders hostage. The maximum response time to process cancellation requests should not exceed 250 milliseconds.

Markets also should be required to update their quotes within 250 milliseconds of an execution. The benefits of automated access to quotes are defeated if markets are not required to automatically update their quotes. Market participants will be attempting to trade with quotes that are no longer available, which is a problem that exists today, and will just result in an increased number of rejected orders.

NASDAQ supports the requirement that markets make public available statistics showing how often they comply with the turnaround time requirement, and proposes that markets make other similar information available. Specifically, if the SEC adopts such requirements, markets must be required to disclose how often they comply with the

maximum response times for quote updates and order cancellation requests. Similarly, if the SEC adopts a rule that distinguishes between automated and non-automated on a quote-by-quote basis, markets that do not provide automated access to their quotes at all times must disclose how often their quotes are not accessible on an automated basis. Requiring disclosure of the information discussed above will impose competitive pressures on markets to remain in compliance with the requirements.

IV. The myth of “best price”

Supporters of the trade-through rule disingenuously describe it as a “best price” rule that protects investors, rather than what it is – a rule to protect floor-based markets from competition.

Best price in today’s trading world is a relative concept. With the change to decimal pricing three years ago, the amount of stock available for sale at a given price has gone down. This was an expected outcome as the minimum spread literally went from Spanish “pieces of eight” to one penny. Lowering the spreads between bid and offer from 12.5 cents (1/8ths) to 6.25 cents (1/16ths) to one penny had a profound impact on trading behavior. Simply put, investors no longer need nor want to slow down their orders to participate in an auction when the best they will get is a one-penny price improvement (and they could see price worsen, or even lose the order entirely). Finding liquidity has become a tougher proposition, so investors reward markets that help them find it, sometimes forgoing a penny or two in order to obtain their needed blocks of stock.

When one considers the effect of the trade-through rule on an actual trade, you can easily see that investors often receive inferior executions at inferior prices, even though their order was delivered to a market on the belief that they would get the “best” price. Quotes carry two bits of important information, the price and the amount of stock offered at that price. Many times, in part because of decimals, the best-priced quotes will only accommodate small amounts of stock. Thus, the trade-through rule can “lure” larger orders to the floor, resulting in the disclosure of vital and material trading information to the specialist. Prices change quickly, and orders end up costing more to an investor, than a one or two cent trade-through in another market would have cost. Lastly, remember that a trade sent to the floor under the trade-through rule carries no mandate for the specialist to actually fill the order at the posted quote. Furthermore, each order does not occur in a vacuum, so quotes can disappear after orders have been routed to the floor for execution. Traders seeking to fill orders are frustrated when they have to wait 30 seconds to learn that they did not get an execution.

With electronic markets, execution surety is a one or two second proposition. Search for liquidity is a point and click proposition. Thus, many investors believe they are getting the best price when they can trade without question, delay or market impact. They are getting best price for their order.

It has also been suggested that institutional investors or brokers may trade-through to the detriment of those for whom they serve as fiduciaries. These arguments are specious. Brokers are judged by their clients and monitored by enforcement officials. Their clients look at the broker’s ability and performance in meeting their needs. Brokers will lose

customers and be subject to disciplinary action if they mistreat the customer orders. It is important to remember, brokers do not want trade-through reform because they want bad prices for their customers, they want reform because they cannot get good prices for their customers on an exchange floor. Their clients do not understand missed trading opportunities. In the point and click era, clients do not accept the manual uncertain methods of the floor exchanges.

Irrespective of the trade-through rule, both investors and intermediaries in the securities markets have fiduciary duties and economic incentives to seek the best price when the best price is a real price (i.e., immediately accessible and tradable). The fundamental problem with the trade-through rule is that it forces market participants to seek a “best” price that may have substantial uncertainty associated with it.

Officials responsible for investing state pension funds and other public monies clearly understand the importance of trade-through reform. Here is just a sample:

- Steve Westly, California’s Chief Financial Officer and a board member of the state’s pension funds CalPERS and CalSTRS: “[R]eforming trade through ... allows [investors] ... to consider factors that may be as important or even more important than the ‘best advertised price’ proviso of the trade-through rule, including quality and speed of execution.”³
- Patricia Anderson, the State Auditor of Minnesota: “The concept of ‘best price’ is an attractive one in principle. Unfortunately, in practice, it has too often become a justification for delayed trades and reduced flexibility. In fact,

³ Letter from State of California Controller Steve Westly to SEC Chairman Donaldson, January 30, 2004.

preliminary information suggests that the rule's mandate to seek the best price has instead often resulted in noticeably higher prices for investors.”⁴

- Charlie Crist, the Attorney General of the State of Florida: “The trade through rule effectively grants floor specialists monopoly power over trading in NYSE listed stocks. As a result, Florida investors (truly all investors) suffer from slower trade executions, increased transaction costs and decreased competition.”⁵
- Resolution of the Alabama State Senate: “... residents of the State of Alabama have large investments in the stock markets... the current trade-through provision is obsolete...proposed reforms will improve investor freedom and preserve investor protection...experience has shown that the most efficient markets are those that permit transparency and individual choice...”⁶
- Sean Harrigan, President, CalPERS Board of Administration: “It is our hope that the regulatory authorities will further improve the efficiency of the markets by eliminating the trade-through rule.”⁷

In closing, the comments of Dr. Benn Steil, Andre Meyer Senior Fellow in International Economics, Council on Foreign Relations, before the House Financial Services Capital Markets Subcommittee, on May 18, 2004 are most instructive:

⁴ Letter from State of Minnesota Auditor Patricia Anderson to SEC Chairman Donaldson, February 20, 2004.

⁵ Letter from State of Florida Attorney General Charlie Crist to SEC Chairman Donaldson, February 12, 2004.

⁶ Resolution of the Alabama State Senate “Urging support for federal Security and Exchange Commission proposed rule No. S7-10-04, to allow for more electronic trading in the national securities market,” adopted May 6, 2004.

⁷ Press release from Sean Harrigan, CalPERS President, Board of Administration, January 14, 2004.

Although the idea of having a simple, market-wide rule to ensure that investors always have access to the “best price” is an attractive one, in practice the trade-through rule has operated to force investor orders down to the floor of the New York Stock Exchange, irrespective of investor wishes. The rule therefore operates to discourage free and open competition among marketplaces and market structures; the type of free and open competition which has in Europe produced a new global standard for best practice both in trading technology and exchange governance. The trade-through rule should therefore be eliminated, as it serves neither to protect investors nor to encourage vital innovation in our marketplace.

V. **Repeal of the Trade-Through rule benefits all investors, including retail investors.**

In the NASDAQ market, where no trade-through rule exists, investors get better prices with faster executions at lower execution costs than they do on the NYSE, where a trade-through rule exists. This is according to the SEC’s own 11Ac1-5 data. These statistics demonstrate that the best execution standard imposed on brokers works for investors.

Retail investors are present in the markets in a number of forms. Some are directly buying securities for their own accounts. Many are accessing the markets as pension fund contributors – from states, businesses, and unions – and a vast majority of individual investors are in the markets through mutual fund share ownership. No matter what form they take, they are important and their trading needs may vary.

Like all consumers, retail investors benefit from competition. NASDAQ investors get better prices because average quoted spreads for NASDAQ-listed securities are tighter than the NYSE equivalents. If we look at NASDAQ in its most actively traded stocks, we have a spread of one penny. Our minimum price variation is one cent. We cannot do any better. These narrow spreads mean that we have vigorous limit order competition in our market. Investors on NASDAQ are the beneficiaries of this competition.

Tighter quoted spreads benefit both traders and investors accessing liquidity.

Furthermore, customers get their orders executed at the NBBO at a higher rate on NASDAQ than on the NYSE for all order sizes. According to the SEC's definition of a trade-through, NASDAQ customers actually trade-through less than the rate on the floor of the NYSE.

In the securities markets, costs are represented by transaction costs as well as spreads.

On Nasdaq, competition has lowered execution costs, as trading platforms have improved efficiencies and vied for order flow.

Finally, investors save money trading on NASDAQ because we are faster. Orders in NASDAQ-listed stocks receive faster executions than orders in comparable NYSE-listed stocks. Faster executions reduce investor uncertainty and decrease the likelihood of the market moving away from the investor's price.

NASDAQ is governed by the principle of best execution. NASDAQ is a better market because brokers have control of their customer's orders and follow best execution for their clients. In 1993, the SEC's payment-for-order-flow release defined best execution

by terms in *addition* to price. Best execution says that one size does not fit all. The Commission specified that liquidity, cost, price impact, accessibility and certainty were other important factors in determining best execution.

Best execution may mean that for small orders, the best price is the customer's one and only priority. It may however mean that for larger orders other factors matter to the customer, like minimizing the impact of his order on the price of the security market-wide. Best execution may include remaining as an anonymous participant in the market or trading where the most stock is available within a certain price range to minimize the price of the entire basket of securities bought at a given time. The current trade-through rule ignores these trading concerns.

Regulation NMS should not be about rolling back carefully evolved principles. I do not want to see the concept of best execution placed in a straitjacket, as the floor markets want.

Supporters of the trade-through rule claim that it protects investors from self-serving brokers and puts the "little guy" on equal footing with the large investment firms and institutional investors. They argue that trade-through reform could be used to give investors inferior prices. But investor complaints and the need for market structure review did not originate based on broker misbehavior, this regimen of change originated on manual floors and complaints emerged from specialists' and floor brokers' misbehavior. These demagogic claims pray on the ignorance of investors and trouble policymakers. They irresponsibly undermine investor confidence. They also are patently false

VI. NASDAQ Exchange Application is Important to Fair Competition.

Finally, I want to discuss one unresolved critical issue. For almost four years now, NASDAQ has awaited word from the SEC on our application to become an exchange. As an exchange, NASDAQ would have a legal structure that companies considering their listing decisions could not question. Currently, NASDAQ is frozen in a partially separated structure that complicates our corporate governance and confuses those looking at us. Many decisions approved by the NASDAQ board still have to be approved by the NASD board.

NASDAQ is a mature, well-developed, and highly efficient market. We trade more shares every day than any market in the world. We diligently protect investors. Our rules are fair and unbiased – and SEC approved.

NASDAQ is working with the SEC to address their remaining concerns. I appreciate the interest of many of the members of this Committee in the status of our application and hope to report back to you soon about that progress.

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Thank you again for this opportunity to testify. I would be happy to answer any questions you may have.