Testimony of

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Chairman Shelby, Senator Sarbanes, and distinguished members of the Senate Banking Committee, thank you for inviting me to discuss Regulation NMS and the recent industry developments.

I. Regulation NMS

When I last appeared before this Committee on July 21, 2004, I started my testimony by stating that: "[t]he trade-through rule is the primary obstacle to competition amongst our nation's equity markets, and competition is the driving force in making the U.S. markets the strongest in the world, the best for investors large and small, and accountable to the public." I also stressed that the markets had uncovered a fundamental truth: "today electronic trading is best for investors."

After well over a year of hearings, discussion, and comments, on April 6, 2005 the Securities and Exchange Commission (the "SEC" or the "Commission") approved Regulation NMS. Regulation NMS replaces the old ITS trade-through rule that protected the listed market from competition with a new trade-through rule which will be applied uniformly across all markets to protect a market's top-of-the-book quote if it is automatically accessible. Regulation NMS also includes needed restrictions on sub-penny trading, establishes uniform market access rules that will insure that all market participants can access each others' quotes, and updates the formula used to allocate market data revenue amongst the SROs.

I believe that Regulation NMS does remove a substantial obstacle to competition amongst our nation's equity markets and establishes incentives for floor-based markets to move to more electronic trading. The new rule will bring benefits to investors and it will enhance the ability of our nation's capital markets to face growing international competition. NASDAQ commends the work of the SEC as well as the constructive oversight of this Committee and the entire Congress throughout the rulemaking process.

As you know, NASDAQ, joined by many others representing both industry participants and investors, urged the Commission to eliminate the trade-through rule entirely. Our position reflected, and still reflects, our belief that market forces and best execution should serve as the bedrock principles in the securities markets. We are proud of the market quality experienced by investors every day on the Nasdaq Stock Market, which does not have a trade-through rule. Given our experience and the costs of implementation, we believe the extension of the rule to NASDAQ imposes a tax on market participants.

Nonetheless, although NASDAQ does not believe the application of a trade-through rule to NASDAQ is necessary given our highly efficient electronic market, we are pleased the new trade-through rule approved by the Commission will force floor-based markets to follow the path to automated trading that has been blazed by NASDAQ since 1971.

Specifically, the Commission's decision to allow investors to make distinctions between fast and slow markets will force manual floor-based markets to automate in order to compete effectively with the faster electronic exchanges. The rule acknowledges the value of speed and certainty of execution, and allows electronic markets to compete for the trading of NYSE-listed securities. Manual markets will no longer be the weak link in the national market system, slowing down faster markets while humans – some with a distinct time and place advantage on the floor – attempt to execute orders.

As you know, the Commission has announced that the rule will be rolled out in a limited manner next April and is not scheduled to take full effect until June 2006, so that markets have time to make and test the necessary system changes. Even before Regulation NMS was approved, however, the NYSE was compelled by market pressure to move to modernize their market structure, and they developed and proposed an electronic-floor hybrid model. Now, as a result of Regulation NMS, the American Stock Exchange and the regional exchanges have strong incentives to modernize their markets and, if they proceed, are poised to emerge as competitors to both NASDAQ and the NYSE in the national market system. There is no doubt that this will be good for competition and for investors.

II. NASDAQ Acquisition of Instinet

On April 22, 2005, NASDAQ announced the acquisition of Instinet Group and, concurrently, entered into a definitive agreement to sell Instinet's Institutional Brokerage division to Silver Lake Partners. As a result, NASDAQ will own only Instinet's electronic communications network, INET.

This deal proceeded from a public, competitive process. Reuters, the parent company of Instinet, announced in November 2004 that it was selling Instinet. We understand that several industry participants considered bids for Instinet. As early as January 25, 2005, as part of a registration statement filed at the SEC, NASDAQ disclosed that we had submitted a non-binding proposal to acquire “a major ECN.”

NASDAQ acquired INET to enhance NASDAQ’s trading environment to serve investors better and respond to the increasing competition across the global capital markets. It is a synergistic deal that will create a fast, high-performing, low-cost single platform for trading U.S. securities. Given the compatibility of the two platforms, the real-time market surveillance by a well-respected regulator, the NASD, and NASDAQ’s proven technological reliability, this transaction will position NASDAQ to compete more effectively with other U.S and international market centers. The acquisition will result in more cost efficiency and improved quality of execution in our market – qualities that today’s individual and institutional investors demand. NASDAQ will continue to innovate and also will have the ability to tap new opportunities in other asset classes.

The combination of NASDAQ and the INET ECN will bring technology enhancements that optimize our electronic trading platform. It will provide greater cost efficiencies to the benefit of investors and improved quality of execution. NASDAQ will be able to offer investors increased limit order interaction. In addition, the INET transaction will allow NASDAQ to continue its market innovation leadership. We will offer faster time-to-market on new products and services that will benefit market participants, investors and our listed companies.

The efficiencies of one integrated platform and single router will provide other benefits as well. Critically, it will enable NASDAQ to maintain its status as the low cost provider for execution services for equities. In addition, by constantly improving and innovating for the benefit of investors, NASDAQ will continue to provide a superior listing venue for public companies and their investors.

III. Dynamic Marketplace

The rapid structural changes sweeping through our nation's securities markets are being propelled by a convergence of several forces, some of which are regulatory in nature, while others are market-driven.

The principal regulatory force is Regulation NMS. Its most direct impact – greater competition in the trading of NYSE securities – will be felt when the rule takes effect. However, the indirect impact of Regulation NMS is being felt already, as the NYSE is poised to become a competitor in the trading of NASDAQ securities. That, combined with the expected rise in the trading of NASDAQ securities by the regional exchanges, which Regulation NMS will serve to encourage, creates a national market structure in which market centers no longer specialize in the equities of a single market. Rather, the NYSE will trade NASDAQ as well as NYSE securities; NASDAQ will be able to more effectively trade NYSE securities; other exchanges and market centers will trade NASDAQ-, NYSE- and American Stock Exchange-listed equities; and large market makers will likewise internally match trades in all of these securities.

Another important force is rapid globalization of capital markets. Companies around the world are seeking access to capital, and stock markets are the key facilitator in this process. When a company in China or Russia seeks to bring capital from outside its country's borders, it typically considers the major markets in Europe as well as in the U.S. As such, we are now competing not just with the U.S. exchanges but also, for example, with the Europeans. Enhanced competition for listings also encourages competition in the quality of trading, as companies seek to list in a country and a market that offers the best trading for their securities.

Finally, it is increasingly necessary for stock markets to be mindful of competition from venues that trade derivatives and other instruments that are not equity securities. If trading quality in equities is inferior or the costs of trading are relatively high, then some investors may prefer to focus on the types of securities that trade more efficiently. Again, all investors are potential winners in this competition.

IV. Improved Regulation

Recent developments in the marketplace offer the opportunity to improve and make more efficient the regulation of the securities markets. First, as part of the NYSE-Archipelago transaction, the NYSE announced their intention to further separate its regulatory function into a non-public, not for profit entity governed by an independent board of directors. NASDAQ supports separating the regulator from the regulated market and, in fact, once the Commission approves our application to register as an exchange, NASDAQ will completely separate from our regulator, the NASD

Broker-dealers who operate on both the NYSE and NASDAQ often become members of the NYSE and the NASD. Accordingly, they face duplicative regulation and costs associated with the regulation. Some companies, like the Charles Schwab Corporation, are moving to eliminate this duplication by dropping their NYSE membership.

Last November, the Commission published a concept release concerning the self-regulatory system of the securities industry. One of the options offered by the Commission in its concept release is the establishment of a hybrid regulator model which would simplify and streamline the current regulatory model. Under this alternative, a market neutral single self-regulatory organization would surveil and enforce rules related to broker-dealers non-market specific activity, such as their financial condition and registered representative representation, while SROs that operate markets would regulate broker-dealers' activities within those markets.

This approach would offer substantial benefits to broker-dealers and investors alike by eliminating the costs associated with duplicative member regulation. At the same time, each market would be in the best position to surveil activity on its own systems and would therefore retain authority over market regulation. The quality of market regulation, moreover, could be enhanced through adoption of intermarket surveillance and audit trail enhancements, and through targeted Commission efforts to promote greater uniformity in SRO market rules in areas where problematic disparities exist.

Accordingly, NASDAQ supports the proposal in the SEC's concept release on SRO governance for a single regulator to administer broker-dealer membership rules.

V. NASDAQ Exchange Registration

Finally, even with Regulation NMS codifying uniform rules for the trading of all equities, there is an additional element necessary to achieve a level playing field – granting NASDAQ status as a national securities exchange. I am pleased to report that the Commission has been working closely with us on our exchange application and we are hopeful that the application will be approved shortly. A NASDAQ exchange will be good for competition, good for the regulatory framework, good for market quality and integrity, and, ultimately, good for investors.