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July 12, 2005

The Honorable Richard C. Shelby
Chairman
The Honorable Paul S. Sarbanes
Ranking Minority Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Michael G. Oxley
Chairman
The Honorable Barney Frank
Ranking Minority Member
Committee on Financial Services
House of Representatives

Subject: *Securities and Exchange Commission: Regulation NMS*

Pursuant to section 801(a)(2)(A) of title 5, United States Code, this is our report on a major rule promulgated by the Securities and Exchange Commission (Commission), entitled “Regulation NMS” (RIN: 3235-AJ18). We received the rule on June 10, 2005. It was published in the Federal Register as “final rules and amendments to joint industry plans” on June 29, 2005. 70 Fed. Reg. 37496.

The final rule includes new substantive rules that are designed to modernize and strengthen the regulatory structure of the U.S. equity markets. First, the “Order Protection Rule” requires trading centers to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution of trades at prices inferior to protected quotations displayed by other trading centers, subject to an applicable exception. To be protected, a quotation must be immediately and automatically accessible.

Second, the “Access Rule” requires fair and non-discriminatory access to quotations, establishes a limit on access fees to harmonize the pricing of quotations across different trading centers, and requires each national securities exchange and association to adopt, maintain, and enforce written rules that prohibit their members from engaging in a pattern or practice of displaying quotations that lock or cross automated quotations.

Third, the “Sub-Penny Rule” prohibits market participants from accepting, ranking, or displaying orders, quotations, or indications of interest in a pricing increment smaller than a penny, except for orders, quotations, or indications of interest that are priced at less than \$1.00 per share.

Finally, the final rule amends the “Market Data Rules” to update the requirements for consolidating, distributing, and displaying market information and also amends the joint industry plans for disseminating market information that modify the formulas for allocating plan revenues and broaden participation in plan governance.

Enclosed is our assessment of the Commission’s compliance with the procedural steps required by section 801(a)(1)(B)(i) through (iv) of title 5 with respect to the rule. Our review indicates that the Commission complied with the applicable requirements.

If you have any questions about this report, please contact James W. Vickers, Assistant General Counsel, at (202) 512-8210. The official responsible for GAO evaluation work relating to the subject matter of the rule is Thomas McCool, Managing Director, Financial Markets and Community Investment. Mr. McCool can be reached at (202) 512-8678.

signed

Kathleen E. Wannisky
Managing Associate General Counsel

Enclosure

cc: Margaret H. McFarland
Deputy Secretary
Securities and Exchange Commission

ANALYSIS UNDER 5 U.S.C. § 801(a)(1)(B)(i)-(iv) OF A MAJOR RULE
ISSUED BY THE
SECURITIES AND EXCHANGE COMMISSION
ENTITLED
"REGULATION NMS"
(RIN: 3235-AJ18)

(i) Cost-benefit analysis

The Commission performed cost-benefits analyses for the various sections of the final rule.

The Order Protection Rule is estimated to have implementation costs of \$143.8 million and annual costs of \$21.9 million thereafter. The annual benefits are estimated to be \$321 million.

The Access Rule's benefits are fair and efficient access to the best-displayed quotations of all trading centers, and the Commission states it will not impose significant costs.

The benefits of the Sub-Penny Rule are clarifying and simplifying pricing for investors, making the U.S. securities markets more competitive internationally, and reducing trading costs by narrowing spreads. The cost of this portion of the rule is estimated to be \$48 million annually.

Finally, the Commission did not quantify the costs or benefits of the portion of the rule dealing with Market Data Rules and Plan Amendments but does not expect the rule to impose significant costs.

(ii) Agency actions relevant to the Regulatory Flexibility Act, 5 U.S.C. §§ 603-605, 607, and 609

The Commission has certified that the final rule will not have a significant economic impact on a substantial number of small entities.

(iii) Agency actions relevant to sections 202-205 of the Unfunded Mandates Reform Act of 1995, 2 U.S.C. §§ 1532-1535

As an independent regulatory agency, the Commission is not subject to title II of the Unfunded Mandates Reform Act of 1995.

(iv) Other relevant information or requirements under acts and executive orders

Administrative Procedure Act, 5 U.S.C. §§ 551 et seq.

The final rule was issued using the notice and comment procedures found at 5 U.S.C. 553. On March 9, 2004, the Commission published a Proposing Release in the Federal Register (69 Fed. Reg. 11126), a Supplemental Release on May 20, 2004 (69 Fed. Reg. 49749), and a Reproposing Release on December 16, 2004 (69 Fed. Reg. 77424). More than 700 comment letters were received and the issues raised are discussed in the preamble to the final rule.

Paperwork Reduction Act, 44 U.S.C. §§ 3501-3520

The final rule does not contain any information collections that are subject to review by the Office of Management and Budget under the Paperwork Reduction Act.

Statutory authorization for the rule

The final rule is promulgated under the authority found in sections 2, 3(b), 5, 6, 11, 11A, 15, 15A, 17(a) and (b), 19, 23(a), and 36 of the Exchange Act (15 U.S.C. 78b, 78c(b), 78e, 78f, 78k-1, 78o, 78o-3, 78q(a) and (b), 78s, 78w(a) and 78mm).

Executive Order No. 12866

As the rule is promulgated by an independent regulatory agency, it is not subject to the review requirements of the order.