



Securities Traders Association Conference

Remarks by Robert Greifeld, President and CEO
The NASDAQ Stock Market

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Thank you Mary for that introduction. It is good to be here this morning. It is fall, our children are back at school hitting the books – at least we hope they are -- and we are back at it with market structure.

We've had some healthy debates as an industry about the future of trading and the future of the markets. I hope I can add to and advance the discussion as we all look toward closure and real change.

In my view, one cannot talk about market structure without first looking at the business of being an exchange.

I spent my career in the private sector, and when I assumed my responsibility at NASDAQ, I was conscious of the fact that NASDAQ had a role beyond its status as a public for-profit company.

Many people told me that operating under the control of an independent agency such as the SEC would be different from my other professional experiences. Having been involved with broker/dealers and the Brut ECN I discounted many of those words of advice. Sixteen months later, I can report that I had received good advice. I am the President and the C.E.O. of the NASDAQ Stock Market but on many issues I have less decision-making capability than I did fifteen years ago as a middle management employee at a large publicly traded company. We at NASDAQ come to work every day intending to gain a competitive advantage. This competition is very intense but it is also very controlled. On a bad day when I cannot implement a simple, tactical move without a public comment period, I feel like I am boxing with kid gloves.

Markets in this country are changing into profit driven enterprises and this is a good thing. I now know that we are dissimilar from most profit driven organizations. The argument could be made that we will be most similar to a regulated utility. Many in this room might be more comfortable if we had that as our corporate charter.

What is our mission at NASDAQ? Our goal at NASDAQ is to facilitate the broker/deal function - they are our defined customers - and we have to ensure that our activities never compete with their function. Our name itself is reflective of that mission, securities dealers were the reason that Nasdaq was created and it is our job to enable and enhance their function.

I started the Brut ECN in 1997. I was a technology person who was mystified by how much Instinet was charging for a basic transaction processing service. The first premise behind the creation of Brut was that an anonymous order matching service was a commodity, utility type of service. The name Brut in fact was an acronym, it stood for Brass Utility. In October of 2004, I am more convinced than ever that our basic matching service is a commodity, it is a utility. The Broker dealers should be charged accordingly.

I have obviously brought this viewpoint with me to Nasdaq and it does direct our efforts. We recognize that the beating heart of our stock market is a transaction-processing engine. Similar to all transaction processing businesses this business has a hardwired default switch that states that, unless you innovate, your service will be paid as a commodity rate. Commodity businesses are good businesses if you bring to the table core competencies in efficiency and are successful in gaining scale in your space. Dell Computers is a great NASDAQ-listed company and is the epitome of the execution of that business model. Many companies that attempt to innovate would love to have Michael's earnings multiple and market capitalization.

We at NASDAQ compete vigorously within the commodity constructs of price, scale and efficiency. Reflective of the commodity reality, we have adopted a price leadership philosophy. This morning we announced the new pricing schedule for the combined NASDAQ Brut market center products. Our

combined pricing is a net reduction to our current industry leading price. A leading competitor's charge per cross is approximately 45% higher than the NASDAQ charge.

With respect to scale, we see our market share in the trading of NASDAQ-listed stocks post Brut acquisition approaching 55% and we more than double our closest competitor's market share. With respect to efficiency, NASDAQ has embarked on a long-term program to be the low cost producer of market services. We have seen our run rate cost basis decline by over \$200 million per annum and we are only in the fourth inning of a nine-inning game.

Because we accept the realities of a commodity driven transaction business, it does not mean that we do not strive to innovate. The lack of an opening and closing process has always been an area where the NASDAQ market could be improved. We studied the role that specialists play on manual floor based markets, and we studied how electronics were utilized in the electronic European markets. We saw a great opportunity to improve the NASDAQ market and leapfrog the opening and closing processes that had been utilized in this country. Our cross represents the first time in this country that a primary market has made the information available to all market participants. We do not give any market participant a privileged and exclusive view of the developing auction.

We are thrilled with the performance of our closing cross and, with the rest of the industry, eagerly await the production release of our opening cross. On the day of the Russell rebalance, our closing cross had mere weeks of maturity. We at NASDAQ were anxious about what the Russell rebalances represented and excited by the ability of the closing cross to bring a new level of efficiency to the trading of NASDAQ stocks. Two Fridays before the Russell rebalance the closing cross experienced a new volume record eight million shares. One week before the Russell rebalance, the closing-cross experienced a new volume record of twenty four million shares.

The day of the Russell we started a NASDAQ betting pool on how many shares would trade in the cross. Low bet was forty million shares, the high bet was one hundred and five million shares. Tensions were high in the control room and as the cross completed we saw the real time stats tell us that we have traded over three hundred and thirty millions shares. Unlike our auction the betting pool was not transparent. A communications specialist from our Connecticut Data Center handled all the action. Only the specialists knew all of the bets. This communication specialists did however, tell certain select individuals about who was a big believer or buyer or who was skeptical and a seller. It came to be known that I was the low bid at forty million shares. No small part of my job at NASDAQ is to be chief cheerleader. Not only did I lose the bet, I failed to do my job.

The day of the launch of the NASDAQ Opening Cross is October 25th. This is date of the first trade in the first transparent opening auction at primary market in this country. You do not want to miss the fun and excitement.

When Brut was established, I was fortunate to be joined by four of the leading sell side firms in this effort. My commitment was that BRUT would never build a liquidity pool through their efforts and other sell side firm efforts and then market that liquidity pool directly to the buy side. I believe that this is the right approach. While this has been the right answer on philosophical grounds, it has been the wrong answer on business terms. Over the past seven years, I have not changed my approach. Competitors to Brut and Nasdaq have successfully built direct agency brokerage business riding on the back of the sell side liquidity in their affiliated ECN. The ECN's that have chosen to pursue this strategy have not been penalized and in fact have enjoyed economic rewards. I believe the time is now when the wisdom of the non-conflicted approach will be recognized.

I believe that the time is now that the philosophical advantages of this non-conflicted approach will dovetail with business advantage. Last year at this gathering, I told this audience that they could not think of themselves as market makers. I stated that the sell side had to identify themselves as being in

the customer execution business. We have seen great progress in this transformation over the past twelve months. Many firms have expanded the concept and practice of their distribution business. Low touch is a term that is now part of our everyday vernacular. When you identify yourself as being a competitor in the low touch business you quickly realize that some of your largest competitors in this space are the ECN's that have been soliciting your order flow.

Over the past sixteen months, we have been chomping at the bit to publicize that conflict to the sell side. We made a conscious effort to refrain from that message until we have the features and the pricing that would make our execution platforms unparalleled in the industry. With the completion of the Brut acquisition we have arrived at that point. We have routing, we have the order types, we have the pricing, and we have the liquidity that the industry requires. Now is the time for the sell side to decide if competitors for your market center business should be required to adopt a non-conflicted business model. It is your decision and your decision alone!

The market data portion of Regulation NMS is of the least discussed sections. This is unfortunate in that market data cries out for structural reform in much the same manner as trade through. Let us take a look at the competitive dynamics in the market data industry. Today the market does not set market data rates. It is fitting and proper to allow the market to set market data rates. Market data rates have been entwined with the concept of payment for regulation and the public policy requirement of ensuring that all investors have access to this critical information. Regulation is the cornerstone of the operation of the market and should have an explicit and guaranteed funding source, which is independent of market data. We completely agree with the public policy that investors should have guaranteed and reasonably priced access to market data. Our position on market data is reflective of the multi-faceted role we play. Our short-term financial interests would direct us to take a position supporting the current NMS proposal. The new formula for allocation of the UTP revenue is favorable to NASDAQ. Instead, we are advocating a reduction in the amount of data governed by the Plan and a dramatic reduction in the fees that investors such as yourself pay for that market data covered by the plan. If our plan is enacted it will be negative to our financials in the short term but will be good for investors.

Also driving our position is the recognition that market data rates were essentially established over twenty years ago. These rates were established when a MIP of mainframe computing power cost \$1,000,000, a gigabyte of storage was \$50,000 and a high-speed line was 9,600 BPS. Because of the existing monopolistic structure of market data and the intertwining of interests, the rates charged have been immune to these dramatic and fundamental changes in productivity of technology. These plans were established to ensure that all investors have reasonable and low cost access to market data. Twenty plus years later, we find the opposite has occurred. All investors have to pay more, for more data than they really need. As a matter of public policy, let us charge a basic rate for basic data that is reflective of the current cost of providing such data.

Let us allow markets through private initiative to innovate and bring additional data products to market and let investors decide if those products are worthy of their purchase. We believe the long-term benefits to our shareholders of a NASDAQ organization that provides innovative data products will outweigh the short-term cost of transitioning away from the current data plans.

Regulation NMS has been debated in forums throughout the country. I have spoken my piece on the topic and for this speech I have decided to "opt out", of the "opt out", discussion. I will however say that in formulating our position at NASDAQ we spent many hours of management time. We would rack our brains trying to understand the intended and unintended consequences of the various positions that others and we might take on each of the issues. Overall, we thought we had developed a comprehensive view on the issues and we were clearly in the mode of communicating those considered opinions to the all interested parties. Around thirty days ago, we realized that we had made a fundamental mistake in our consideration of Regulation NMS.

As we had hammered out our thoughts on Regulation NMS, we involved the brightest minds associated with the NASDAQ mission and we developed our positions in an intellectually honest manner. Our cerebral discussions were a success. Our failure was not realizing that Regulation NMS is as much about practicality as it is about philosophy. While we debated the philosophy of the trade through rule we gave little weight to the practicality of implementing this rule on actively traded stocks. When I speak of the practicality, I am not, at this point, speaking of the cost of implementation. I am questioning when implemented, can the rule as stated actually work in the real world?

If the quote update rate on a particular stock is faster than the response time on an order to trade that stock, than the ability of the broker/dealer to avoid a trade through is a matter of luck. If I try to hit a bid on XYZ stock and the average duration of a bid on XYZ stock, is 3/10 of a second and my average time to reach that bid is 4/10 of a second, then on average I will violate the trade through rule because on average that quote would have changed. The Commission has identified this situation as a "false positive". It is impossible to build a fair system of regulation where the violators are forced by the rule to always violate the rule.

To limit the incidents of false positives, the Commission might be forced to specify certain parameters that would define how long a quote must have to be standing, how long a quote was in the market before that quote can be considered traded through. For example, a particular trade would be deemed to have violated the trade through rule if it was executed at a price inferior to a quote that had been standing for the required time. Quotes that did not stand for the requisite time, could not, in effect, be considered "traded through".

If we accept this approach as a way to overcome the false positive problem in a trade through rule world, the question we asked ourselves is what percent of the trading on NASDAQ and the NYSE would be exempted from the trade through rule. If we establish the parameters that a quote has to be standing for one second before and one second after the subject trade, than 34% of Nasdaq trades and 21% percent of NYSE trades would be exempted from the trade-through rule. If the parameter were that a quote had to be standing for five seconds before and two seconds after the subject trade then 58% of Nasdaq trades and 45% of NYSE trades would be exempted from the trade through rule. If NYSE does implement their hybrid market plan their trade through exemption would more closely reflect the NASDAQ numbers.

Even more interesting was the analysis that we did on some of most actively quoted stocks. The percent of trades exempted from the trade through rule ranged from 80% under the 3/1 test and 89% under the 5/2 test. I have just given you many stats, maybe too many, but what we are saying is that a real life Trade Through Rule might not be technically able to apply to 90% of the trading activity in a given stock.

Practicality is defined by do-ability and cost. I have great faith in the technical staffs on Wall Street. They can build the systems that would count the time duration of every one of the hundreds of millions of quote updates in the market. They could build the systems that would then utilize that data to determine if a defined trade through would occur. It would however be the biggest and costliest development effort that equity trading had ever witnessed.

What would be the benefit of this huge expenditure when the rule itself would not even apply to a large percentage of trading activity?

It is impossible to regulate that quote update times and system response times must always be equal. We are witnessing the direct intersection of regulatory initiatives with technological realities of the marketplace. We can safely predict that will be a larger and larger issue in the future.

In this particular case, we are asking the industry to spend so much for little or no return to investors. If I can leave you with a few thoughts, it is that:

- Exchanges are not traditional businesses. We must strive to be world-class enterprises within the confines of controlled competition.
- In the transactions area we compete within the commodity constructs of price, scale and efficiency. But it does not prevent us from innovating and improving the efficiency of our markets.
- The sale of Market Data today is not subject to competitive forces. Essential data should be priced to reflect the realities of lower cost data generation and dissemination.
- I would call for increased innovation in data products that represent value-add for investors and can be priced accordingly.
- Lastly, we cannot create regulations that do not meet the rigors of technological and practical implementation.
- The time is now for the sell side to decide if they want to demand that market centers step away from conflicted business models.