October 25, 1994

The Honorable Arthur Levitt
Chairman
The Securities and Exchange Commission
450 Fith Street, N.W.
Room 600
Washington, D.C. 20549

Dear Chairman Levitt:

There have been several recent news reports about potentially improper and anticompetitive trading activities by market makers in the Nasdaq market system. The articles report practices such as "trading through" and "trading ahead" of customer orders by Nasdaq market makers. Further, the Justice Department's Antitrust Division is conducting an investigation into certain of these activities.

These reports raise concerns that investors may not always be getting "best execution" price for their orders. They also raise concerns that these practices will reduce investor confidence in our capital markets and that the NASD, a self-regulatory organization, has permitted this practice to exist.

I request that the Securities and Exchange Commission conduct a review of these alleged practices and provide me with a complete written report of its findings. The review should, at a minimum, consider the following issues:

Have market makers in the Nasdaq stock market colluded to maintain wide spreads in certain high-volume Nasdaq stocks?

Do Nasdaq market makers typically trade with each other at prices that are between their published bids and offers while executing investor orders at published prices? If so, what percentage of Nasdaq trades are between the spreads? Of these trades between the spreads, what percent are between market makers and what percent are between market makers and investors?

Once the SEC's proposed rule on Nasdaq limit orders is in place, will it be possible for market makers to fill customer orders at prices inferior to the prices at which market makers are trading?
Is the SEC considering prohibiting or further restricting the ability of market makers to have a two tier trading system where market makers trade among themselves at better prices and narrower margins than they trade for investors? If so, please describe.

Do Nasdaq market makers delay reporting their trading within the ninety second period required? If so, has this delayed reporting become routine?

In its recently completed "Market 2000" study, did the Commission staff review the spreads in the Nasdaq market and compare them to the spreads on stock exchanges? Does the Commission have plans to study this area in the future?

Is the NASD's regulatory oversight of Nasdaq adequate, in the Commission's view, to detect and prevent practices which are unfair to investors and inconsistent with the objective of fair and free competition in the securities markets?

I know you share my concern on this issue which is so vitally important to maintaining a capital market with integrity. Kindly report back to me on your findings on these issues, and any other matters pertaining to the Nasdaq market makers that may be relevant to this inquiry. I would appreciate your written report no later than December 31, 1994.

Sincerely,

Alfonso M. D'Amato
Ranking Member