

January 15, 2002

Annette Nazareth
Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

Public Avail. Date: 2/8/02 0211200242
Act Section Rule
1934 11A(c)(1) 11Ac1-1
1934 11A(c)(1) 11Ac1-4

Re: Brut, LLC

Dear Ms. Nazareth:

On behalf of Brut, LLC ("Brut"), which is registered with the Securities and Exchange Commission (the "Commission") as a broker-dealer, and an Alternative Trading System ("ATS") under Regulation ATS, we respectfully request that the Division of Market Regulation (the "Division") advise Brut that:

1. The Brut ECN System (the "System") is an electronic communications network (an "ECN"), as defined in paragraph (a)(8) of Rule 11Ac1-1 ("Quote Rule") and paragraph (a)(7) of Rule 11Ac1-4 ("Limit Order Display Rule") under the Securities Exchange Act of 1934 ("Exchange Act");
2. The System complies with the "ECN Display Alternative" as described in paragraph (c)(5)(ii) of the Quote Rule with respect to exchange-listed securities for which a linkage between the System and the NASD's Computer Assisted Execution System ("CAES") is operational; and
3. The Division would not recommend that the Commission take enforcement action under the Quote Rule against any OTC market maker or exchange specialist who is a participant in the System and would not recommend that the Commission take enforcement action under the Limit Order Display Rule against any OTC market maker or exchange specialist, as those terms are defined or used in paragraphs (a)(9) and (b)(1) of the Limit Order Display Rule, if such market maker or specialist transmits orders to the System in reliance on the assumption that the System is in compliance with paragraph (c)(5)(ii) of the Quote Rule and paragraph (c)(5) of the Limit Order Display Rule with respect to such orders and if such market maker omits to take any other action that otherwise would be required if the System were not in compliance with such provisions.

Description of the System

The System will provide participants with automatic execution, clearance and settlement of trades in exchange-listed securities.¹ A wholly-owned subsidiary of Automated Securities Clearance Ltd. (the "Subsidiary") licenses the System software to Brut, which operates the System. In connection with its operation of the system, Brut is registered as a broker-dealer, is a member of the National Association of Securities Dealers, Inc. (the "NASD"), and is registered as an ATS.

Broker-dealers registered with the Commission are permitted to become System participants. Brut provides the participant's institutional customers and other institutional investors with direct access to the System (i.e., the ability to enter and route orders directly to the System from a computer terminal located on the institution's premises).

Broker-dealer participants who subscribe to Automated Securities Clearance Ltd.'s Brokerage Realtime Application Software System ("BRASS") and/or Universal Market Access software ("UMA") are able to access the System through said systems. Participants who subscribe to BRASS also are able to use BRASS to route orders to Brut through the BRASS Network (BNET), just as BRASS subscribers may route orders to other broker-dealers through BNET, but there is no automatic default for unexecuted orders between Brut and any other system or service.

A broker-dealer participant need not subscribe to BRASS or UMA in order to be able to access the System. If a participant does not subscribe to BRASS or UMA, Brut makes available an application program interface (API) that permits such participants to read and view the System utilizing their existing hardware and systems. In lieu of, or in addition to, the API, Brut provides participants with a direct feed through which they can view the System on their own display devices, and enter and execute orders on the System.

Brut makes the Brut Workstation software (the "Brut Workstation") available for institutional participants to access the System. Brut makes available an application program interface (API) that permits such participants to read and view the System utilizing their existing hardware and systems. In lieu of, or in addition to, the API, Brut provides participants with a direct feed through which they can view the System on their own display devices, and enter and execute orders on the System.

¹ The Commission has previously granted no-action relief for the System with respect to Nasdaq National Market and Nasdaq SmallCap stocks. See April 21, 1998 Letter regarding the Brass Utility System by Richard R. Lindsey, as updated by various letters. Accordingly, this letter only seeks a no-action position with respect to exchange-listed securities and the System.

Participants access the System by using a password and user identification codes. As described below, only participants and authorized personnel at Brut and Subsidiary will have access to the System. The identity of participants and their trading records are kept confidential.

The System will permit participants to display priced orders in exchange-listed stocks on an anonymous basis. Orders will be transmitted and displayed to all System participants. No participant will be able to limit the ability of other participants to view the orders that they transmit. Participants' orders that match as to price will be executed automatically through the System. If the size of an order does not match, then the System will execute a partial fill.

Brut is in the process of establishing a linkage with the Computer Assisted Execution System ("CAES"), which will provide for the dissemination of, and access to, all best-priced System orders in exchange-listed securities to broker dealers for execution. CAES is an automated system operated by The Nasdaq Stock Market, Inc. ("Nasdaq") that allows NASD members to direct agency orders and principal orders (provided they are a CQS market maker in the stock) in exchange-listed securities to CAES for automatic execution against CAES market makers. The Intermarket Trading System (the "ITS") is a software/hardware system operated by Securities Industry Automation Corporation ("SIAC") that interconnects competing exchange markets for the purpose of choosing the best market. ITS/CAES is the NASD's link to ITS that enables ITS/CAES market makers in listed securities to direct agency and principal orders to/and receive orders from the floors of participating ITS exchanges. Only CQS market makers registered as ITS/CAES market makers with the NASD are eligible to participate in the ITS/CAES link. In conjunction with the CAES linkage, Brut will register as an ITS/CAES Market Maker and will register as a CQS Market Maker.

Brut will operate a telephone help desk staffed by appropriately registered personnel during normal trading hours. During that time, participants will be able to call and place orders for display on the System, as well as to take out orders displayed on the System. The help desk also will respond to any questions or problems that participants have with the System. Help desk personnel will be subject to a strict policy prohibiting the disclosure of such information to anyone outside of Brut (with the exception of Subsidiary's technicians), or to unauthorized personnel within Brut. In the event of a technical problem within the System, information concerning trades may be disclosed to technicians employed by Subsidiary, but only to the extent, if any, necessary to permit such technicians to correct the problem.

Matched orders will be cleared and settled in either one of two ways, as elected by the participant. First, a participant may instruct Brut to clear and settle a trade. As such, Brut will act as introducing broker for both sides of each trade. Brut will report the trade data to its clearing broker, which will clear and settle the transaction on a fully-disclosed basis in accordance with established securities industry practice. Alternatively, the participants may make their own clearing arrangements. Upon becoming a participant, a broker-dealer participant will be permitted to identify broker-dealer participants that it wishes to clear with directly. When two broker-dealer participants execute a trade together and each participant has included the

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other on its "list," the System will automatically notify the two parties of the trade detail and their respective identities. The parties then will be able to proceed with clearing the trade through their own clearing arrangements.

Participants will be permitted to elect to supplement their displayed orders by also entering non-displayed quantities at the same prices into the System. These quantities, referred to as "reserves," will not be displayed to System participants. The reserves will be sequenced in priority of execution behind all other displayed orders at the same price. If a participant so desires, it may automatically replenish its displayed order. Once the displayed portion of an order has been executed, the participant's order will be automatically replenished by the same amount as the original displayed order (or such lesser amount if the amount of the reserve is less than the amount of the original order) and the amount of the participant's reserve reduced by a like amount. To include a reserve amount, a participant must be willing to display at least 100 shares.

Brut is organized as a limited liability company. The business and affairs of Brut are under the direction of the governing body of Brut, Inc., a minority owner and the manager of Brut (the "Manager"). Day-to-day management of Brut rests with officers appointed by the governing body of the Manager. Such persons are not employed by Automated Securities Clearance Ltd. or their affiliates or subsidiaries. The governing body of the Managers' access to information about a participant's trading activity is limited to a need-to-know basis, and they, together with Brut's officers and employees, are prohibited from using any confidential information that they might learn with respect to such participants, or from disclosing confidential information to others except on a need-to-know basis.

Discussion

1. The System is an ECN within the meaning of the Quote Rule

Exchange Act Rule 11Ac1-1(a)(8) defines an ECN as "any electronic system that widely disseminates to third parties orders entered therein by an exchange market maker or OTC market maker, and permits such orders to be executed against in whole or in part."

The System will electronically allow participants, including OTC market makers and exchange specialists, to enter orders in exchange-listed securities for dissemination to other participants, who can then effect executions, in whole or in part, against those orders. Accordingly, the System will satisfy the definition of an ECN.

2. Compliance with the ECN Display Alternative

Paragraph (c)(5)(ii) of the Quote Rule provides that an exchange market maker or OTC market maker that has entered a priced order for a covered security into an ECN that widely disseminates such order shall be deemed to be in compliance with paragraph (c)(5)(i)(A)

of the rule if the ECN meets two criteria.² First, it must provide to a self-regulatory organization for inclusion in the public quotation system, the best prices, and the sizes associated with such prices, for a security that exchange market makers and OTC market makers have entered into the ECN for that security. Second, it must provide non-subscriber brokers and dealers with access to prices entered in the ECN that is functionally equivalent to the access that would have been available if the prices had been published in the exchange market maker's or OTC market maker's own quotation.

The System will satisfy both requirements. Specifically, Brut will: (i) transmit to Nasdaq for display to Nasdaq Workstation II, CAES, and Consolidated Quotation System ("CQS") subscribers the best priced orders of all orders entered by market makers or exchange specialists for the exchange-listed securities in which they make markets or act as specialist; and (ii) provide to any broker or dealer access to such orders displayed to such participants that is functionally equivalent to the access that would have been available had the market makers or exchange specialists reflected their superior orders in their quotes.

As discussed above, Brut will establish the necessary link to CAES/ITS in order to satisfy the dissemination and equivalent access requirements of the ECN Display Alternative in conformance with NASD Rule 4623 and the Electronic Communications Networks (ECN) Addendum to Nasdaq Workstation II Subscriber Agreement. Registration as a ITS/CAES Market Maker and as a CQS Market Maker, in conjunction with the linkage to CAES, will enable Brut to widely disseminate orders entered into the System. Brut will provide to CAES/ITS the best prices and sizes that participants enter into the System with respect to exchange-listed stocks in the public quotation data made available by CQS. Similarly, the CAES and ITS linkage will assure that non-subscriber broker-dealers will have access to orders entered into Brut in a manner that is functionally equivalent to the access that would have been available had the market maker or exchange specialist reflected their superior order in their quote: the linkage enables all ITS/CAES Market Makers to interact with orders from the floors of participating ITS exchanges.

3. Access

The System response time for non-participants' orders will be no greater than the System response time for responding to participants' orders and normally will occur within a few seconds of receipt. Consistent with CAES requirements, Brut will not charge fees to non-subscribers for access to its System through the CAES/ITS linkage.

² Paragraph (c)(5) of the Limit Order Display Rule provides an exception from that rule for any customer limit order that is delivered immediately upon receipt to an ECN that complies with the requirements of paragraph (c)(5)(ii) of the Quote Rule with respect to that order. 17 CFR 240.11Ac1-4(c)(5)

4. The System will honor its quotes

The System will honor its quotes unless the System has a substantial basis for believing that the counterparty to the transaction will not be able to honor the trade. In Brut's opinion, a substantial basis for believing that a counterparty will not be able to honor a trade will exist if:

- the counterparty fails to settle a trade by settlement date (T+3);
- the counterparty's clearing firm has indicated it is no longer willing to clear for the counterparty;
- the NASD's Automatic Confirmation Transaction Service ("ACT") has publicized that the counterparty has exceeded its SuperCap and its clearing firm is not willing to honor its trade; or
- the counterparty refuses to disclose its financial condition on a timely basis to Brut upon Brut's reasonable request (or, in the case of a counterparty that is not self-clearing, its clearing firm refuses to disclose its financial condition on a timely basis upon Brut's reasonable request).

5. Capacity

Brut i. ther represents that the System has sufficient capacity to handle the volume of data projected to be entered into the System. Moreover, Brut will conduct periodic system capacity reviews and tests to: (i) to ensure future capacity; (ii) identify potential weaknesses; and (iii) reduce the risks of system failures and threats to system integrity.

Conclusion

On the basis of the foregoing, we respectfully request that the Division advise Brut that:

1. The System is an electronic communications network for exchange-listed securities as defined in the Quote Rule and the Limit Order Display Rule;
2. The System complies with the ECN Display Alternative with respect to exchange-listed stocks for which a linkage between the System, CAES/ITS and CQS is operational; and
3. The Division will not recommend that the Commission take enforcement action under the Quote Rule or under the Limit Order Display Rule against any OTC market maker or exchange specialist, if such market maker or specialist transmits orders in exchange-listed securities to the System in reliance on the assumption that the System is in compliance with paragraph (c)(5)(ii) of the Quote Rule and paragraph (c)(5) of the Limit Order Display Rule with respect to such orders and if such market maker or exchange specialist omits to take any other

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action that otherwise would be required if the System were not in compliance with such provisions.

If you have any questions or seek any additional information regarding this matter, please contact the undersigned at (917) 637-2560.

Sincerely,



William O'Brien
Senior Vice President & General Counsel
Brut, LLC

cc: John Polise, Senior Special Counsel, Division of Market Regulation

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Bloomberg
TRADEBOOK LLC
Member NASD/SIPC

00096

February 7, 2002

U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549-0609

Attention: Mr. Jonathan Katz, Secretary

Re: SEC File No. SR-NASD-2001-90

Ladies and Gentlemen:

Bloomberg Tradebook LLC ("Bloomberg Tradebook")¹ appreciates the opportunity to comment, in response to the request by the Securities and Exchange

¹ Bloomberg Tradebook operates a proprietary electronic communications network ("ECN") pursuant to Regulation ATS under the Securities Exchange Act of 1934 (the "Exchange Act") and a no-action letter from the staff of the Commission's Division of Market Regulation. Letter from Dr. Richard R. Lindsey to Roger D. Blanc (January 17, 1997), SEC No-Action Letter, 1997 SEC No-Act. LEXIS 55 (the "Bloomberg Tradebook No-Action Letter"). The Bloomberg Tradebook No-Action Letter was extended on several occasions, most recently on June 14, 2001. Bloomberg Tradebook is a registered broker-dealer and a member of the National Association of Securities Dealers, Inc. (the "NASD"). Bloomberg Tradebook offers its institutional and broker-dealer customers, and other broker-dealers that access the Tradebook system via private connections and Nasdaq's SelectNet, the opportunity to buy and sell equity securities through use of the BLOOMBERG PROFESSIONAL service (as defined below).

Bloomberg Tradebook is a wholly owned subsidiary of Bloomberg L.P. ("Bloomberg"). Bloomberg is engaged in the business of providing its customers with financial market information, news and analytics via its worldwide electronic network (the "BLOOMBERG PROFESSIONAL™ service"). Bloomberg also serves its broker-dealer and institutional customers' communications needs and facilitates their transaction of business by offering various additional services, including electronic messaging, non-anonymous offerings, bids wanted and equity order-routing and indications of interest, and linkages to certain exchanges within and outside the United States. Approximately two million text messages and transaction messages involving billions of dollars of securities are sent and received by Bloomberg customers across the BLOOMBERG PROFESSIONAL service every business day. In addition, we expect in the future to provide access to additional points of liquidity as customer demand dictates.

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Commission (the "Commission") in Securities Exchange Act Release No. 45156 (December 14, 2001) (the "ADF Release") on a proposed rule change filed with the Commission by the National Association of Securities Dealers, Inc. (the "NASD") that would (i) revise the NASD rules in anticipation of approval of the registration of The Nasdaq Stock Market, Inc. ("Nasdaq") as an exchange and its proposed separation from the NASD and (ii) establish the rules to govern OTC trading, including the implementation and operation of the NASD's Alternative Display Facility (the "ADF").

I. PRELIMINARY REMARKS

Bloomberg Tradebook fully supports the establishment of the ADF. We believe there is a need for the NASD to provide an OTC market that will be an alternative to Nasdaq and other exchanges. We strongly endorse the decision of the Commission to condition approval of Nasdaq's pending application for registration as a national securities exchange² and Nasdaq's launching of SuperMontage³ upon the establishment by the NASD of an ADF. A facility for trading exchange-listed securities in the over-the-counter ("OTC") market should provide market makers, ECNs and order-entry firms a fair opportunity to obtain efficient execution of orders. It should provide a framework for participants to create a viable and robust alternative to Nasdaq and other exchanges and be in place before Nasdaq commences business as an exchange and before the launch of SuperMontage. Bloomberg Tradebook believes that the NASD has presented the essential elements of such a facility in the ADF Release.

We note that the press recently reported that the Commission encouraged NASD-R to consider an alternative resolution to a matter relating to Island ECN ("Island").⁴ At issue is the fact that not all investors can see Island's best bid and offer for the Nasdaq 100 tracking stock, or "the QQQs", that is traded on Island's system. While we share the concern of those who suggest that something must be done to bring all trading in the QQQs into the national market system, we believe this issue requires a market-structure resolution, not enforcement action. The problems raised by limited visibility of Island's quotations in the QQQs are, we believe, the kinds of problems that the ADF will address. We are encouraged by the Commission's restraint and good judgment while awaiting resolution of ADF issues.

² See Securities Exchange Act Release No. 44396 (June 7, 2001), Notice of Filing: II. Nasdaq's Exchange Registration.

³ See Securities Exchange Act Release No. 43863 (January 19, 2001), in text after note 462.

⁴ Gretchen Morgenson, *In a New World, a Puzzling Directive from the S.E.C.*, N.Y. Times, January 27, 2002, Business Section, p. 1. See also, *Case Against Island Planned by NASD Meets SEC Objection*, The Wall St. J., January 28, 2002, p. C28.

We consider the NASD's proposal fundamentally sound and we are convinced that the issues and questions raised by the ADF Release can and ought to be resolved expeditiously. We would like to call the Commission's attention to certain critical issues about the ADF. We believe the clarification of these issues is essential to the Commission's evaluation of the ADF as well as the ADF's ultimate commercial success or failure.

II. DESCRIPTION OF THE NASD'S PROPOSED ADF

The ADF is a facility that the NASD will build to provide its members with the ability to do OTC trading in listed securities (i.e., listed securities of the NYSE, Amex and Nasdaq, once Nasdaq becomes a registered exchange). As proposed, the facility would provide market participants the ability to collect and view quotations and to report transactions to the appropriate securities information processor ("SIP") for consolidation and dissemination to data vendors and ADF market participants. The proposed facility also would provide for trade comparison and for real-time data delivery to NASD Regulation, Inc. ("NASD-R"), a wholly owned subsidiary of the NASD. The ADF would be maintained and operated by the NASD or a vendor other than Nasdaq. Under the proposal, NASD-R would enforce the proposed rules and provide market surveillance.

The ADF would not provide an order-routing capability. Instead, ADF market participants would be required to provide direct electronic access to their quotations to other ADF market participants and indirect electronic access to all other NASD members seeking access to their quotations. Under the NASD's proposal, ADF market participants could satisfy these requirements either by providing their own bilateral linkages or by participating in multilateral linkage facilities provided by private vendors.

The ADF proposal uses the term ITS/ADF market makers in referring to participation in the Intermarket Trading System (the "ITS") by both market makers and ECNs. Under the ADF proposal, participation in the ITS, with the associated obligations such as compliance with the trade-through rule and the market-probing requirement, would be completely voluntary. The ADF would not use Nasdaq's Computer Assisted Execution System ("CAES") to effect ITS trades. Accordingly, market participants would be responsible under proposed NASD Rule 4300 to establish links to facilitate execution of Consolidated Quotation System ("CQS") securities in what the NASD calls the "intra-market" and, in the case of non-ITS participants, direct or indirect linkages to the exchanges.

The NASD's ADF proposal would clarify that NASD rules that relate to trading practices apply only to OTC trades by NASD members in exchange-listed securities. The Over-the-Counter Bulletin Board would not be part of the ADF; it is unclear whether it would become part of the Nasdaq-listed stock market or, if not, on what basis Nasdaq would continue to operate it. Proposed NASD Rule 6620 would

require NASD members that effect OTC trades in securities that are not listed on any national securities exchange to use Nasdaq's Automated Confirmation Transaction Service ("ACT") for trade comparison and trade reporting.

III. ISSUES, RECOMMENDATIONS AND QUESTIONS REGARDING ESTABLISHING AND FUNDING THE ADF

A. ADF: A proposal with promise

We believe the ADF is a progressive, simple solution that will benefit the market. In formulating the ADF proposal, the NASD's staff has shown a clear understanding of the potential of today's technology: the falling cost of bandwidth over the past few years has made it easy and economical for market participants to link to one another. The proposed ADF rules apply to the technology that participants will use to build the market, not to building the market itself. This distinction is critical. The ADF would not create a central "hub" because one is not needed. Market participants would link to each other using their own technology, thereby eliminating reliance on a single facility and its unavoidable single point of failure. The result would be a facility that is flexible enough to grow with and respond to technological innovation. In sum, the ADF is not an instrument of monopoly. It would allow market participants to send their quotations to a SIP without having to go through Nasdaq or the SuperMontage. It would establish a sound framework of rules, the purpose of which is to underpin a fair and orderly market within which competition should flourish.

The NASD's treatment of ITS participation in the ADF proposal exemplifies its approach to market structure. Currently, under the ITS Plan and the ITS rules imposed on Nasdaq market makers, market participants that register to enter quotations in CQS securities (i.e., currently, in the "third market" in securities listed on the American or New York Stock Exchanges) must participate in the ITS. Under the proposed ADF rules, on the other hand, the NASD would not "unilaterally impose such an inter-market linkage obligation" with respect to trading in Nasdaq-listed securities.⁵ Presumably, then, the establishment of inter-market linkages would be completely voluntary for NASD members quoting in Nasdaq-listed securities. In the case of exchange-listed securities that are CQS securities, NASD members would be free to elect whether to participate in the ITS. If they chose to do so, they would become subject to the full panoply of ITS requirements such as the trade-through and market-probing requirements. If they chose not to participate in the ITS, those requirements would not apply. Market participants that quote in the ADF but choose not to participate in the ITS would be obliged to establish their own links to facilitate execution of CQS securities and

⁵ ADF Release, Part 3, 1. Purpose, in text following n 19.

would not be subject to a mandatory, centralized technology or a market structure imposed by regulation. It is our understanding that, in the case of Nasdaq securities, NASD market makers would have to accept links from any other NASD members.⁶ In essence, then, the ADF proposal offers a superstructure of rules, a framework and an arena within which quoting market participants would be able to build, trade, innovate and compete. It is an approach to market structure and regulation we fully endorse.⁷

B. The NASD's commitment to the ADF

We are optimistic about the NASD's commitment to the ADF, but recognize the current special situation of the NASD and the potential for conflicts of interest. We support the ADF not only on the basis of our review of the proposal itself, but also on the basis of our confidence in the NASD staff with whom we have met and conferred regarding the ADF. We believe the ADF proposal represents a firm institutional commitment on the part of the NASD.

At the same time, we are aware that the NASD as an institution is in the midst of a major transition. The NASD's separation from Nasdaq is not a single event; it is a process. On the basis of our review of the ADF proposal and our work with the NASD staff, we believe the NASD is moving in the right direction.

We are concerned, nonetheless, that the NASD may not be sufficiently independent of Nasdaq to establish and sustain the independent institutional commitment needed to make the ADF a successful competitive alternative to Nasdaq. Although the NASD currently retains a minority equity interest in Nasdaq, it retains voting control of Nasdaq common stock through a voting trust. Upon Nasdaq's registration as a national securities exchange, the NASD will no longer control the voting rights in the common stock of Nasdaq, but it will hold preferred stock of Nasdaq and warrants for Nasdaq common stock.⁸ Given the NASD's continuing interest in Nasdaq through its ownership of Nasdaq's preferred and warrants on Nasdaq's common stock, it is unclear to what extent the NASD will become truly independent of Nasdaq and its success or failure as a for-profit exchange.

⁶ See NASD Notice to Members 02-01 (January 2002) at p. 5.

⁷ As noted below, however, the proposed requirement that ECNs quote a two-sided market in CQS securities would impose a competitive burden on ECNs since they would not necessarily have participant orders on both sides of the market. See Section IV.E., below.

⁸ See NASD News Release, January 24, 2002, available on the Internet at: http://www.nasdr.com/news/pr2002/release_02_007.html.

Once it is registered as a national securities exchange, Nasdaq will receive from the NASD through a Separation and Common Services Agreement between the NASD and Nasdaq the same administrative, corporate and infrastructure services as the NASD currently provides to Nasdaq, as well as such additional services and responsibilities as the parties may mutually agree.⁹ In addition, following approval of its exchange registration, Nasdaq will enter into a Regulatory Services Agreement with NASD-R, under which NASD-R will provide to Nasdaq full regulatory services, all related administrative functions and any additional services to which the parties mutually agree.¹⁰

With an interlocking directorate between the NASD and Nasdaq and with many of the key officers of Nasdaq being current or former NASD officers who retain close ties to those left behind in the NASD, it is not at all clear that the NASD is sufficiently independent of Nasdaq to be firmly committed to creating an OTC market that would offer a commercially viable alternative to Nasdaq and other exchanges. The senior officers and board members of the NASD are significant shareholders with strong institutional ties to Nasdaq. The ADF, if it were successful, could compete directly with Nasdaq and diminish the economic rewards for those officers and shareholders.¹¹ The result is a real potential for conflict of interest within the NASD that poses a challenge not only to the strength of its institutional commitment to the ADF but also to its independence as the rule-making body and, through NASD-R, the regulator of both Nasdaq and the ADF.

⁹ See Form 10, General Form for Registration of Securities Pursuant to Section 12(b) or 12(g) of the Securities Exchange Act of 1934, File No. 000-32651, filed with the Securities and Exchange Commission by The Nasdaq Stock Market, Inc., on April 30, 2001 (the "Form 10"), Exhibit 10.6.

¹⁰ *Id.*, Exhibit 10.5.

¹¹ As of June 29, 2001, the date Amendment No. 2 to the Nasdaq Form 10 was filed with the Securities and Exchange Commission, Frank G. Zarb was both Chairman of Nasdaq and Chairman of the NASD board and Messrs. H. Furlong Baldwin, Frank E. Baxter, John D. Markese, David S. Pottruck, Arthur Rock, Richard C. Romano, and Arvind Sodhani were members of both the NASD board and the Nasdaq board. Nasdaq Form 10 (Amendment No. 2), Item 7, Certain Relationships and Related Transactions, "The NASD". In addition, Nasdaq has noted that, "Conflicts of interest may arise between Nasdaq and the NASD, or its affiliates, in a number of areas relating to their past and ongoing relationships including the nature, quality, and pricing of services rendered; shared marketing functions; tax and employee benefit matters; indemnity agreements; sales or distributions by the NASD of all or any portion of its interest in Nasdaq; or the NASD's ability to influence certain affairs of Nasdaq prior to Exchange Registration." Nasdaq Form 10 (Amendment No. 2), Item 1, Business, "Risk Factors—Nasdaq faces potential conflicts of interest with related parties."

Bloomberg Tradebook believes that to be a credible alternative to the Nasdaq stock exchange and other exchanges, the ADF must be an independent marketplace. That, in turn, requires that the NASD itself be independent of Nasdaq. To ensure the NASD's independence and the confidence of market participants in the ADF, we urge the Commission to consider requiring the NASD to divest itself of its holdings in the Nasdaq stock market. In addition, we would suggest that members of the NASD board should not serve simultaneously on the boards of the NASD and of Nasdaq.

Given the Congress's direction to the Commission in Section 11A of the Exchange Act to use its authority to facilitate the establishment of a national market system,¹² we believe that the Commission was correct in concluding that the NASD should develop an alternative display facility to provide an OTC market as a condition to Nasdaq's becoming a for-profit exchange. Together with Section 15A(b)(11) of the Exchange Act, Section 11A(c)(1) of the Exchange Act sets forth clear standards the NASD must meet as a self-regulatory organization, including the obligation to ensure equal regulation of all markets.¹³ In addition to the clear congressional intent and the express provisions of the statute that speak to the need for the NASD's independence and impartiality, the NASD is also bound by the Commission's Order of August 8, 1996 censuring the NASD (the "1996 Order").¹⁴ To the extent that the NASD and its wholly owned subsidiary, NASD-R, are not independent of the Nasdaq market, the resultant conflict of interest stands in clear violation of the 1996 Order and the related consent decree. We urge the Commission to exercise its authority to ensure that the process of the NASD's transition is firmly grounded in the fundamental requirement that the NASD be independent and impartial.

C. Response times

We recommend that all market participants quoting in the ADF be obliged to respond to orders sent to them in the same rapid manner as is required of ECNs under the Commission's no-action letters.¹⁵ We recognize that this would require market

¹² See Section 11A(a)(2) and (3) of the Exchange Act.

¹³ Section 11A(c)(1)(F) of the Exchange Act.

¹⁴ Securities Exchange Act Release No. 37538 (August 8, 1996).

¹⁵ See, e.g., *Bloomberg Tradebook System*, SEC no-action letter (January 16, 2001), 2001 SEC No-Act LEXIS 44:

Tradebook should respond to orders entered into Tradebook through SelectNet access no slower than Tradebook responds to orders entered directly into the [Tradebook]System, and in any event in no more than a few seconds.

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makers to develop electronic capabilities that would permit rapid response, but we believe most market makers currently have such systems and the cost to those who do not would not be excessive. Imposing such a requirement would serve an important public interest in that it would promote market efficiency and eliminate the "gamesmanship" that currently attends the 30-second rule applicable to Nasdaq market makers. The increased speed and efficiency would promote fairness and market transparency. Market makers that elected not to embrace the required technology could still make markets in Nasdaq securities through the existing channels.

D. Funding the ADF

Upon its separation from Nasdaq, the NASD will lose a significant source of revenue. The ADF Release does not provide projections detailing how much the ADF will cost, how NASD proposes to finance the ADF on an ongoing basis or how much the NASD's revenues will depend, directly or indirectly, upon the success of Nasdaq as a stock exchange.¹⁶ In the ADF Release, for example, the NASD states that existing fees and assessments, including the gross assessment and Section 8 fees, would continue to apply to NASD members and that any specific fees or assessments with respect to the ADF would be the subject of a future rule filing. Those statements alone, however, do not provide an adequate basis for determining the attractiveness of the ADF to potential quoting market participants or the potential financial viability of the proposed ADF. The financing of the ADF is an integral part of its viability. For fully informed public comment on the ADF Release, the NASD should be required to provide a plan for financing the ADF. The Commission should not allow the NASD and Nasdaq to finesse these important questions by burying them in a separate, as yet undisclosed, set of proposed rule changes that the NASD presumably will file for immediate effectiveness under Exchange Act Section 19(b)(3).

E. Clarification of the application of current rules to the ADF

Bloomberg Tradebook respectfully suggests that the Commission consider taking or initiating the following minimum steps to clarify the application to the ADF of current rules as they would apply to ADF participants:

- One effect of Nasdaq's registration as an exchange would be to alter the application of the Quote Rule, Rule 11Ac1-1 under the Exchange Act. Although

¹⁶ How the NASD will finance the ADF affects the NASD's residual and potentially conflicting commitment to Nasdaq. For example, if Nasdaq pays NASD-R for regulatory services based upon Nasdaq's trading volume, it could create a clear financial incentive for the NASD to bolster the commercial success of Nasdaq. We would suggest that NASD-R be paid based upon a measure not connected to Nasdaq's success such as, for example, the number of registered representatives or the number of member firms.

the Commission never adopted its proposed amendment that would have required dealers that account for more than 1% of the trading volume in Nasdaq-traded securities to register as Nasdaq market makers,¹⁷ dealers in Nasdaq-listed securities will automatically become subject to the existing 1% requirement under the Quote Rule once Nasdaq becomes an exchange. If the Commission has not found it necessary or appropriate to subject dealers in Nasdaq securities to the 1% requirement up to now, we question why that requirement should automatically apply upon Nasdaq's becoming an exchange. We would suggest that the Commission evaluate whether to amend the Quote Rule to change that result.

- The proposed ADF rules are silent with respect to the Order Audit Trail System ("OATS") reporting. We understand from conversations with the NASD staff that OATS reporting will remain unchanged under the ADF in that participants quoting in the ADF will report order information to OATS in the same manner as they do today for orders placed with Nasdaq. In addition, the comparison function between OATS and ACT currently used for orders in Nasdaq will be replicated between OATS and the Trade Comparison and Reporting Service ("TRACS"), the trade-reporting system for the ADF. We believe this is the most sensible arrangement and we favor it. We request that the Commission clarify this issue and require the NASD to address OATS reporting in a revision to the ADF rules.

- We note that neither the ADF proposal itself nor the ADF Release addresses Rules 11Ac1-5 and 11Ac1-6 under the Exchange Act. We urge the Commission to provide guidance regarding the application of the disclosure of order execution information, governed by Rule 11Ac1-5, and the disclosure of order routing information, governed by Rule 11Ac1-6, for participants in the ADF.

IV. REGULATORY ISSUES: THE VENDOR DISPLAY RULE, LOCKED AND CROSSED MARKETS, THE SHORT SALE RULE, TRADE REPORTING AND QUOTING IN CQS STOCKS

A. The ADF and compliance with the Vendor Display Rule¹⁸

The NASD would not disseminate to market participants quoting in the ADF any consolidated quotation or trade data in a security from securities exchanges and market centers. The NASD would require ADF market makers to obtain from vendors dynamic quotations and last-sale information on the securities they trade through the

¹⁷ Securities Exchange Act Release No. 37620 (August 28, 1996).

¹⁸ Rule 11Ac1-2 under the Exchange Act.

ADF, and to display this data in close proximity to the ADF data displayed on their terminals—just as Nasdaq currently requires of CQS market makers in Rule 6330(c).¹⁹

It is not clear to us whether the NASD will collect depth-of-market data and distribute it to market participants that quote in the ADF. We believe this information is indispensable in a decimalized marketplace. Bloomberg Tradebook would like to display its own depth-of-market information in the ADF and to receive the depth-of-market data of all other market participants that quote in the ADF. While we do not believe the NASD should have to collect and distribute Level II depth-of-market data from the outset, the Commission should encourage the NASD to do so as soon as possible thereafter. Once the NASD does make those data available, the Vendor Display Rule should be extended to cover depth-of-market data. Just as the Vendor Display Rule today prohibits vendors from making Level I data from one exchange available with fewer keystrokes than would be required to access the Level I data from the consolidated data feed, the same principle should apply to depth-of-market data.

The NASD stated in the ADF Release that it plans concurrently with the filing of the ADF Release to request an exemption from the Vendor Display Rule. The substance of that exemptive request was not published. We believe the Commission should not approve that request without public notice and solicitation of public comment since it has an important bearing on the matters discussed in the ADF Release and may well have deleterious effects on market participants.

B. Locked and crossed markets

Bloomberg Tradebook favors the use of locking as a means of sending a directionally biased signal to the market, indicating whether there is upward or downward pressure on the prevailing market price. That information can be critical to market participants who are formulating trading strategy and determining what prices they should offer or receive. To be able to lock, a market participant that wishes to bid (offer) in a market venue at a price equal to the current offer (bid) should be able to do so only if it is willing to transact in a size greater than the size of the quotation it would lock. It should have to enter an order to the market participant whose quotation it would lock or cross at a size equal to the size of that market participant's quotation. At the same time, the market participant should be able to enter a quotation at the same price for the remaining excess quantity. For example, if there is an offer for 1,000 shares at 30, a market participant should be able to send an order to buy 1,000 shares at 30 and at the

¹⁹ Proposed Rule 4613(e)(2) would require a registered NASD market maker to have in close proximity to the ADF terminal or interface at which it makes a market in a Nasdaq security, a quotation service that disseminates quotations in that security on behalf of national securities exchanges and other market centers.

same time enter a bid at 30 for whatever additional quantity it wished to buy. If that were permitted, system delays in processing the 1,000-share buy order would not stand in the way of the entry of the locking quotation for the additional quantity. At the same time, the ADF should prohibit crossing the market. All market participants quoting in the ADF should be bound by the ECN Display Rule,²⁰ that is, a market participant quoting in the ADF should not be permitted to display in an electronic system provided to its clients a better price than it displays in the ADF. Finally, we would submit to the Commission that rules for locking and crossing markets should be the same across all markets.

Under current NASD rules, locking and crossing also affects the opening price of the market. To address the problem, Bloomberg Tradebook recommends that participants in the ADF not be restricted from entering quotations when the market is closed. Quotations made outside of trading hours should not be mandatory, but, if made, should be firm. The requirement that market makers quoting in the ADF make two-sided markets should apply only during regular market hours (9:30 a.m. to 4 p.m., or until 1 p.m. on half days). Quotations made when the market is closed should not be subject to that requirement. This would obviate the need for makeshift solutions to locking and crossing like the NASD's current Trade or Move rules.²¹

C. The short-sale rule

Proposed NASD Rule 5100 would prohibit NASD members from effecting a short sale in a Nasdaq National Market Security otherwise than on an exchange at or below the current national best (inside) bid when that bid is below the preceding national best (inside) bid in that security. In Section II of the ADF Release, the NASD explains that the ADF rule is intended to mirror Nasdaq's short-sale rule in large part, with the sole change to the rule being the substitution of the national best (inside) bid for the Nasdaq best bid.²² The NASD states that use of the national best (inside) bid "would be more reflective of market-wide trading in a security and therefore would better further the purposes of the rule."

The NASD does not explain, however, the implications of the change in the rule on the ADF itself or how such a change would affect trading in a two-market system. Currently, NASD Rule 3350, governing short selling in Nasdaq National Market Securities, needs only a single referent quotation, the best (inside) bid. If the NASD would now require integration of quotations on the Nasdaq exchange and quotations in

²⁰ Rule 11Ac1-1(c)(5)(ii) under the Exchange Act.

²¹ NASD Rule 4613(e).

²² Based upon conversations with Nasdaq, there is no indication that Nasdaq intends to change its short sale rule.

the ADF, it should address the question whether sufficient systems exist to prevent timing problems in collecting and sequencing quotations from the two market centers. The issue will be of no consequence to Nasdaq itself once it becomes an exchange, we presume, since short selling on Nasdaq will then become subject for the first time to the Commission's own short-sale rule, Rule 10a-1 under the Exchange Act, under which the short-sale prohibition is based on the last sale, not any current quotation. In the ADF short-sale rule, on the other hand, the quotations on Nasdaq will be relevant, which may pose practical problems. To the extent the inside bids on the ADF and Nasdaq may be subject to an absence of timing synchronization or other reporting discrepancies, it may well be that the prohibition proposed for the ADF will rely on an inaccurate portrayal of the best inside bid because of timing or other disparities in the data.²³

The changing status of Nasdaq will have an important impact on the application of the existing regulatory structures governing short sales. For example, once Nasdaq's exchange registration is granted and short selling in Nasdaq securities becomes subject to Rule 10a-1 under the Exchange Act,²⁴ should ADF market makers be subject to Rule 10a-1 as well, just as third-market makers today are subject to that rule when they trade in CQS securities? Alternatively would short selling in Nasdaq securities be subject to a trade-based "tick test" under Rule 10a-1 if the trades are effected on the Nasdaq exchange but to a "bid test" under the proposed NASD Rule 5100? We think the Commission should provide clarity on those issues.

²³ NASD and Nasdaq Rules 2320(a) require market participants to "use reasonable diligence to ascertain the best inter-dealer market for the subject security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions." Among the factors used to determine "reasonable diligence" is the number of markets checked. Under the best execution rules, a market participant may be obliged to effect a short sale in any market that is trading on a plus or zero-plus tick rather than a minus or zero-minus tick. Further, if a short sale order is entered into Nasdaq while both Nasdaq and the ADF are trading on a down bid, and the ADF begins trading on an up bid, a market participant may either choose or be obliged to pull his or her quotation from one market to effect a trade in the other.

As the Commission knows, in the case of the Commission's short-sale rule, Rule 10a-1 under the Exchange Act, both the New York Stock Exchange and the American Stock Exchange avoid this problem by electing the local-market provision in paragraph (a)(2) of Rule 10a-1, which allows a national securities exchange to designate regular-way pricing on its own market, rather than the last reported sale on the Consolidated Transaction Reporting System, as the price referent for purposes of determining permissibility of short selling on that market. See, e.g., Explanatory Note re Rule 440B, 2 New York Stock Exchange Guide (CCH) ¶2440B.

²⁴ See Securities Exchange Act Release 44396 (June 7 2001) in text at n.9.

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D. Trade reporting under the ADF

The ADF would support a "three party trade report", that is, a single last-sale trade report that would denote one reporting member (i.e., the party with the trade reporting responsibility as defined in Rules 4633 and 6420) and two contra parties. The ADF would be designed to split the three-party trade report into two separate reports that would then be processed independently in accordance with existing trade reporting rules. In addition, we have confirmed with staff of the NASD, that to the extent the trade reports are filed in the ADF, the details will not be divulged to ADF participants, thus assuring anonymity.

Bloomberg Tradebook supports the proposed "three party trade report" design. The proposed rules, however, are not clear on related issues such as ACT Attachment II agreements between broker-dealers, sometimes called trade report "give-ups" or ACT Automatic Give Up Agreements ("AGUs"), which empower one broker-dealer to report on behalf of another for 90-second volume reporting and/or locked-in trade clearance. Specifically, will the ADF rules change the way trades are counted for market making activity when a market maker buys or sells through an ECN?

ADF will replace separate print and clearance reports with a single report. Will such reports function in ways similar to ACT Attachment II AGU reports? Under the current system, broker-dealers voluntarily submit Attachment IIs. We need clarification from NASD as to whether Attachment IIs will be retained under the ADF proposal. While we endorse the added efficiency of consolidating trade reports in ADF with trade reports in Nasdaq, it is important that trades be properly attributed to broker-dealers and market makers for transactions they effect on the ADF through ECNs. In addition, we recommend that reporting of market-maker trading volumes be consolidated and reported by the SIP, representing trading both on Nasdaq and through the ADF.

E. Quoting in CQS stocks

Proposed NASD Rule 6320(a) would require Bloomberg Tradebook to register as a CQS market maker to quote in CQS stocks in the ADF. As a CQS market maker, Bloomberg Tradebook will be required to make two-sided quotations in all stocks during market hours. Proposed Rule 6330(d) prohibits computer-generated quotations. Since Bloomberg Tradebook may not always have buy and sell orders in all CQS stocks, our system will need to generate quotations at limits well away from the current inside, or last sale. We note that the Archipelago ECN displays bid quotations in the ITS at \$0.01. While the intent of the proposed rule is to prevent systems from generating large volumes of quotations, the exceptions do not appear to cover the need for an ECN to be able to generate quotations sufficiently far away from the inside to avoid receiving orders. We seek the Commission's guidance with respect to compliance with proposed Rule 6330(d) by ECNs that are CQS market makers.

F. Application of the Section 28(e) safe harbor to the ADF

The Commission recently issued an interpretive release in which it has concluded, at the request of The Nasdaq Stock Market, Inc., that the soft-dollar safe harbor in Exchange Act Section 28(e) is available for certain riskless principal transactions in Nasdaq securities, as described in the Commission's release, where the trades are reported under certain Nasdaq rules and the markup, markdown or other transactional compensation is disclosed on the securities confirmation sent to the fiduciary customer.²⁵ Securities listed on Nasdaq will be traded over the counter via the ADF. It would be anomalous to extend the Commission's current interpretation of the Section 28(e) harbor to trades in Nasdaq securities reported under certain Nasdaq rules but not to trades in the same securities on the ADF if there happen to be differences between certain trading rules of the facility and of Nasdaq. Given the competitive implications of inclusion or exclusion from the safe harbor, we respectfully recommend that the Commission clarify that its interpretation will apply equally to both market venues.

V. **THE ADF SHOULD BE A FULLY OPERATIONAL AND VIABLE FOR A TRIAL PERIOD BEFORE FINAL APPROVAL OF NASDAQ'S EXCHANGE REGISTRATION AND THE LAUNCHING OF SUPERMONTAGE**

In the ADF Release, the NASD notes that in the SuperMontage Order, the SEC required the NASD to create a facility that "permits NASD members to comply with their obligations under Commission and NASD rules (including Exchange Act Rule 11Ac1-1(c)(5) and Regulation ATS) without participating in the Nasdaq execution facility. The facility will identify through the central processor the identity of the NASD member that is the source of each quotation," as is required by Exchange Act Rule 11Ac1-1(b)(1)(ii). Furthermore, the NASD continues, the Commission stated that "[t]he facility will provide for a market neutral linkage to the Nasdaq and other marketplaces, but not an execution service." The NASD concludes that it believes that the proposed rule change fulfills the obligations specified by the Commission in the SuperMontage Order. In particular, the NASD believes that the proposal would provide a market-neutral linkage by requiring market participants to link, either directly or indirectly, to all those seeking access to the market participants' quotations as required in proposed NASD Rule 4300.²⁶ To date, however, the Commission has not clarified how complete and functional the ADF must be to warrant approval of Nasdaq's exchange registration and the commencement of SuperMontage.

²⁵ See Securities Exchange Act Release No. 45194 (December 27, 2001)

²⁶ See ADF Release, Part 3, 2. Statutory Purpose, in text following n.20.

The ADF will be a fledgling facility with new technology for its order-collection and -display functions and an order-execution system that will consist of access linkages among ADF members. In the course of development of SuperSOES and, more recently, with SuperMontage, Nasdaq has taken time to test its new facilities before beginning operation. Bloomberg Tradebook believes that the ADF also should have the time that will be needed to test its systems before they become operational. In addition, once the ADF facility becomes operational, we believe the Commission should permit it to operate for a period of time long enough to determine that it is not only fully operational, but also a viable alternative market, before the Commission grants Nasdaq's registration as an exchange and permits it to put SuperMontage into operation.

In sum, we urge the Commission to continue to condition its approval of both Nasdaq's exchange registration and the commencement of SuperMontage on the establishment of a fully operational and viable ADF. The conditions make equitable sense in that Nasdaq has, in effect, appropriated facilities built up over the years by NASD members and transformed them into facilities of a for-profit exchange from which a relatively few insiders stand to receive considerable rewards. The conditions make economic sense in that they provide an incentive to the NASD to commit its resources to the ADF and provide a needed counterbalance to the NASD's ongoing interest in Nasdaq's success. A design for an ADF, no matter how well conceived it may appear, is not enough. To satisfy the requirements of the Exchange Act, and meet the needs of the securities markets and investors, the ADF must be put in place, it must be tested and it must work. To defer operation of the ADF for some period of weeks or months after the SuperMontage/SuperSOES monopoly is allowed to flourish not only would run the risk that the ADF would lose tempo and not ever be able to catch up but it also would remove much of the leverage the Commission now has to ensure that the energy and momentum behind creating a workable ADF are real and not illusory. Potential participants will not build linkages to the market participants quoting in the ADF until they see that it actually works.

Regardless of when the ADF becomes operational, we urge the Commission to require Nasdaq, once it becomes an exchange, to provide SelectNet linkage to market participants quoting in the ADF for at least four months after ADF is launched, as a means to facilitate and encourage potential participants to connect to and participate in the new OTC market.

VI. CONCLUSION

Bloomberg Tradebook strongly supports the ADF proposal. We believe the staff of the NASD have presented a simple and effective solution for meeting the NASD's obligation to provide an OTC market to replace Nasdaq. In sum, the ADF provides for the dissemination of quotations and the execution of orders through linkage among market participants within the framework of a coherent body of rules, rather than through the imposition of a centralized facility. The result is a proposal that holds the

promise for an OTC market that will encourage competition and innovation, provided the Commission remains an active and vigilant participant in the process.

We support the Commission's decision to condition the approval of Nasdaq's exchange registration and the commencement of SuperMontage on the establishment of the ADF. We believe the NASD's obligation to construct the ADF arises from the statute and we believe its obligation to regulate the ADF fairly and impartially rests squarely on the Commission's 1996 Order and the related consent decree. We are concerned, however, that the NASD complete its transition from parent of Nasdaq to a self-regulatory organization that can and will independently and impartially regulate both the ADF and the new Nasdaq exchange. We think it is essential that the Commission require the NASD to take more active steps to disengage itself from its institutional and financial connections to Nasdaq. Without that independence, we do not believe the NASD will be able to instill confidence that the ADF is a fair and orderly market.

As we noted earlier, we were encouraged by the Commission's restraint in responding to the issues raised by Island's market in QQQs. We support the Commission's decision to work toward a market-structure solution to the Island problem because these issues will be addressed in connection with the ADF. We are confident that the same kind of cooperation between the Commission and the NASD will facilitate the NASD's separation from Nasdaq, secure its independence as a regulator and ensure that the ADF has the opportunity to become a robust OTC market.

* * *

We appreciate the opportunity to make our views known to the Commission and the staff and we hope that our letter is helpful. If members of the Commission or of the staff believe we may be of further assistance in these matters, please let us know.

Very truly yours,

Bloomberg Tradebook LLC

By: *Kevin M. Foley*

cc: The Hon. Harvey L. Pitt, Chairman
The Hon. Isaac C. Hunt, Jr., Commissioner
The Hon. Cynthia Glassman, Commissioner
Annette L. Nazareth, Esq., Director,
Division of Market Regulation

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DIVISION OF
MARKET REGULATION

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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February 1, 2002

William O'Brien
Senior Vice President & General Counsel
Brut, LLC
55 Broadway
New York, New York, 10006

Act	Securities Exchange Act of 1934
Section	11A
Rule	11Ac1-1; 11Ac1-4
Public Availability	2/8/02

Re: BRUT System

Dear Mr. O'Brien:

In your letter, dated January 15, 2002, you request that the Division of Market Regulation extend the current no-action position regarding The BRUT ECN, LLC's ("BRUT System" or "System") activities in Nasdaq securities to include exchange-listed securities. Specifically, you request that the Division of Market Regulation confirm that BRUT System operated by BRUT, LLC ("BRUT") is an "electronic communications network" ("ECN") as defined in the amendments to the Quote Rule¹ ("ECN Amendment") and the Limit Order Display Rule² (cumulatively, "Order Execution Rules") for exchange-listed securities. You also request that the Division confirm that the BRUT System will be in compliance with the requirements under the ECN Display Alternative³ set forth in the ECN Amendment with respect to exchange-listed securities for which a linkage between the BRUT System and the Nasdaq system is operational. In addition, you request that the Division not recommend that the Commission take enforcement action under the ECN Amendment or the Limit Order Display Rule against OTC market makers or exchange specialists who are participants in the System, if those participants enter orders into the System without modifying their public quotations in compliance with the Order Execution Rules.

In connection with this request, you have represented that the BRUT System complies with the ECN Display Alternative. In this regard, BRUT is currently in the process of

¹ Rule 11Ac1-1 under the Securities Exchange Act of 1934, 17 CFR 240.11Ac1-1. See Securities Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290.

² Rule 11Ac1-4 under the Securities Exchange Act of 1934, 17 CFR 240.11Ac1-4. See Securities Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290. The definition of ECN contained in the Limit Order Display Rule incorporates by reference the definition of ECN in the ECN Amendment.

³ See discussion, infra.

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establishing with Nasdaq an operative linkage with the Computer Assisted Execution System (the "CAES linkage"), which will provide access to all displayed best-priced System orders in exchange-listed securities. CAES serves as the NASD's interface with the Intermarket Trading System ("ITS"). In conjunction with the CAES linkage, BRUT will register as an ITS/CAES market maker and as a CQS market maker, and its best-priced orders will be publicly disseminated.

You also represent that BRUT will allow broker-dealers the ability to effect transactions with orders in the BRUT System via the CAES linkage or through a telephone desk staffed by employees who meet applicable NASD qualification standards. You represent that BRUT will not charge fees to non-subscriber broker-dealers for access to the System through the CAES/ITS linkage.

On the basis of the representations contained in your both your January 15, 2002 letter and your January 22, 1998 letter, the Division confirms that the System is an ECN for exchange-listed securities as defined in the Order Execution Rules. The Division also preliminarily believes that the BRUT System will be in compliance with the requirements under the ECN Display Alternative set forth in the ECN Amendment with respect to exchange-listed securities for which a linkage between the BRUT System and ITS/CAES is operational.⁴ Accordingly, the Division will not recommend that the Commission take enforcement action under the ECN Amendment or the Limit Order Display Rule against OTC market makers or exchange specialists who are participants in the BRUT System, if those participants enter orders into the BRUT System without modifying their public quotations in compliance with the Order Execution Rules.

The Division conditions its position on compliance by the System with the non-discrimination provisions of the Addendum to the Nasdaq Workstation II Subscriber Agreement (i.e., Section 2, Response Time). The Division notes that compliance with the ECN Amendment depends in many respects on the practical effect of the operational conditions established by the BRUT System and the manner of the operation of the linkage between the BRUT System and Nasdaq. Therefore, the Division is limiting its assurances regarding compliance with the ECN Amendment and the ECN Display Alternative and the Division's no-action relief to the period ending March 31, 2002.

⁴ This determination specifically does not apply to securities for, or during hours in, which a linkage between the BRUT System and CAES/ITS is not operational.

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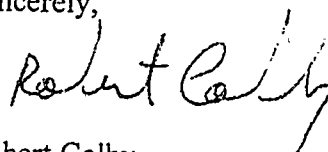
The Division further conditions its position upon your representation in your letter that the BRUT System has sufficient capacity to handle the volume of trading reasonably anticipated in its System. Such capacity should be ensured through periodic review and testing to (1) ensure future capacity, (2) identify potential weaknesses, and (3) reduce the risks of system failures and threats to system integrity. The Division may, in the process of its continuing review of ECNs, request records from the BRUT System regarding such reviews and tests. In addition, the Division may request additional representations from the BRUT System regarding the operation of the BRUT System.

The Division further conditions its position upon your representation that the trading information entered into the BRUT System will be kept confidential by those employees of BRUT having access to it, and that the operation of the System will be kept separate from the other business of BRUT. The Division, in the process of its continuing review of ECNs, may request records concerning procedures addressing these issues. Further, the Division will consider extending or modifying its temporary no-action position prior to March 31, 2002, based on its continuing experience with the operation of the ECN Display Alternative.

The Division further conditions its position upon BRUT's compliance with all terms and conditions, as applicable, of the Commission's November 13, 1998 letter to BRUT regarding Nasdaq securities.

This no-action position regards enforcement action under Section 11A of the Exchange Act only, and does not express legal conclusions regarding the applicability of Section 11A of the Exchange Act or other statutory or regulatory provisions of the federal securities laws. This no-action position is also based solely on the representations you have made. Any different facts or conditions might require a different response. This no-action position is subject to changes in current law, regulation, and interpretations; any such change may require the Division to reevaluate and withdraw or modify this position.

Sincerely,



Robert Colby
Deputy Director