



DIVISION OF
MARKET REGULATION

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

June 15, 2006

Alan J. Reed, Jr.
First Vice President & Director of Compliance
Instinet Group, LLC
3 Times Square
New York, NY 10036

Re: Rule 10a-1; Extension of Exemptive Relief under Short Sale Rule
TP File No. 06-79

Dear Mr. Reed:

In your letter dated June 15, 2006 as supplemented by telephone conversations with the staff of the Division of Market Regulation ("Division"), you requested on behalf of Instinet, LLC ("Instinet"), a registered broker-dealer, that the Securities and Exchange Commission ("Commission") grant a one-year extension of the existing temporary exemption from Rule 10a-1 under the Securities Exchange Act of 1934 ("Exchange Act") for transactions executed through Instinet's Intraday Crossing System ("IDX").

A copy of your letter is attached to this response. By including a copy of your correspondence, we avoid having to repeat or summarize the facts you presented. The defined terms in this letter have the same meaning as in your letter, unless otherwise noted.

In your letter, you make the following representations, among others:

The Commission previously granted a temporary one-year exemption from Rule 10a-1 under the Exchange Act for transactions effected through the IDX¹ (the "2005 Exemption"). In your letter of June 8, 2006, you represented that the operation of the IDX remains identical to that described in the 2005 Request and it reiterates all statements made in the 2005 Request. You also represent that Instinet will continue to comply with all conditions set forth in the 2005 Exemption.

You previously represented that IDX is an alternative trading system that matches buying and selling interest among institutional investors and broker-dealers at

¹ See Letter from James A. Brigagliano, Assistant Director, Division of Market Regulation, to Jon Kroeper, First Vice President and Associate General Counsel, Instinet Group, LLC, dated June 8, 2005 (the "2005 Request").

various set times during the day. IDX was designed to meet the special needs of institutional customers, including broker-dealers, who trade in terms of portfolios of stocks by providing an electronic order entry mechanism to facilitate trading in portfolios. IDX also allows participants to enter single stock orders. IDX matches currently are scheduled to occur three times a day ("Regular Matches"), with the pricing of each match occurring at random times during specific one-minute windows from 9:50 to 9:51 a.m.; 11:50 to 11:51 a.m.; and 2:50 to 2:51 p.m.

Instinet clients generally transmit their orders (which are unpriced) by means of electronic interfaces, or by telephone or facsimile to the Instinet trading desk. All orders entered into the system for execution are confidential. The matching and execution of matched orders occurs immediately following the selection of the match price during each one-minute random pricing window. Instinet personnel do not have discretion to delay a match and matches are delayed only to the extent there are technical difficulties with the system. Instinet personnel may not solicit orders from clients or otherwise communicate to clients that a match has not yet occurred during a one-minute match window. All orders involving securities listed on an exchange that are matched by the system during the Regular Matches are priced at the midpoint of the consolidated national best bid and offer quotation ("NBBO") for the security selected during the one minute random pricing window.

The IDX Regular Matches will sometimes take place at a price that is below the last reported price for that security in the consolidated transaction reporting system. Absent an exemption, short sale orders executed in IDX Regular Matches could result in violations of Rule 10a-1.

You previously stated that you believe that short sales executed through the IDX do not involve the types of abuses that Rule 10a-1 is designed to address. In support of this, you noted that: all IDX trades are processed on an anonymous basis and prices are fixed at the midpoint of the consolidated NBBO for the security selected during the one minute random pricing window; there is no price discovery within the IDX because orders are not displayed and no participant can be assured of a match and no participant knows precisely when the match will occur. You also state that all short sale orders entered in the IDX will be appropriately marked in accordance with applicable rules. You also previously stated that Instinet has established procedures to monitor changes to bids and offers for stocks traded in IDX matches to look for signs of manipulation. If Instinet suspects that a subscriber has engaged in a manipulative activity through the IDX, Instinet will report such activity to the appropriate SRO.

In view of the passive nature of pricing for the IDX system, you have previously requested that the Commission grant an exemption from Rule 10a-1 for Instinet's institutional customers, including broker-dealers, that execute short sale transactions through Instinet's Regular Matches.

Response:

Rule 200 of Regulation SHO² defines the term "short sale," and Rule 10a-1 governs short sales generally. Paragraph (a) of Rule 10a-1 covers transactions in any security registered on a national securities exchange, if trades in such security are reported pursuant to an "effective transaction reporting plan" ("Reported Securities"). A short sale of a Reported Security listed on a national securities exchange may not be effected at a price either: (1) below the last reported price of a transaction reported in the consolidated transaction reporting system ("minus tick"); or (2) at the last reported price if that price is lower than the last reported different price ("zero-minus tick").

Absent relief, trades effected in the IDX Regular Matches involving short sales of exchange-listed Reported Securities would have to comply with the "tick test" of paragraph (a) of Rule 10a-1. As described above, Regular Matches in the IDX occur at the mid-point of the NBBO, which can result in short sales being effected at prices lower than the last reported sale price. Based on your prior representations, in particular, that: the IDX Regular Matches will occur at an externally derived price within the existing market and above the current best bid; there is no price discovery within the IDX because orders are not displayed; no participant can be assured of receiving a match; and the matches will occur on a random basis within each window so no participant knows precisely when the match will occur, the Division is of the view that IDX trades would not appear to involve the types of abuses that Rule 10a-1 was designed to address.

Accordingly, on the basis of your representations and the facts presented and without necessarily concurring with your analysis, the Commission hereby grants a one-year extension of the existing exemption from Rule 10a-1³ to permit short sales effected during the IDX Regular Matches, as described above, without complying with the "tick" provisions of the rule, subject to the following conditions:

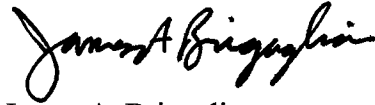
1. Persons relying on this exemption shall not be represented in the primary market offer or otherwise influence the primary market bid or offer at the time of the transaction;
2. Transactions effected through the IDX shall not be made for the purpose of creating actual, or apparent, active trading in or depressing or otherwise manipulating the price of any security;

² 17 CFR 242.200.

³ The existing exemption was granted on a one-year pilot basis. The extension is also being granted on a one-year pilot basis. Accordingly, Instinet will provide, six months from the date of this exemption, written records to the Division documenting the operation of the IDX system.

the adequacy of the disclosure concerning, and the applicability of any federal or state laws to, the proposed transactions.

For the Commission, by the Division of Market
Regulation, pursuant to delegated authority,

A handwritten signature in black ink, appearing to read "James A. Brigagliano". The signature is written in a cursive, flowing style.

James A. Brigagliano
Acting Associate Director

the day of the proposed short sale or during any 60 consecutive calendar days ending within the 10 calendar days preceding the date of the proposed short sale.

<http://www.sec.gov/divisions/marketreg/mr-noaction/instinet060805.htm>

[Home](#) | [Previous Page](#)

Modified: 10/14/2005