



**BERNARD L. MADOFF**  
**Investment Securities**

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January 5, 1995

The Honorable Arthur Levitt  
Chairman  
U.S. Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, DC 20549

Dear Arthur,

Enclosed is a copy of our announcement to our clients that we have concluded our pilot and begun our Nasdaq initiative. The letter also contains a detailed description of our services and examples which we believe will clearly define the benefits of our system.

We hope you will find this informative and look forward to your comments. Best wishes for a healthy and prosperous New Year.

Sincerely,

Peter B. Madoff

Bernard L. Madoff

PBM/cg

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Affiliated with:

Madoff Securities International Ltd.  
43 London Wall, London England EC2M 5TB.071-374 0891



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Dear Client,

We are happy to announce that on January 3, we will begin offering our new Nasdaq execution services. The initial pilot phase which began on December 5 was confined to a group of our broker-dealer clients who agreed to participate with us in developing these exciting new services. We have successfully concluded the pilot and now invite all of our clients to participate with us in this Nasdaq initiative. The next phase will extend our coverage to the top 100 Nasdaq securities and should be fully implemented by March 30. On January 3, we will be trading 40 securities (see enclosed list). To help you fully understand the superior execution services that we offer for Nasdaq securities, we have enclosed a detailed description of how our system will operate.

**Market Orders / Price Improvement**

Each of your customers' market orders in Nasdaq securities that you deliver to Madoff will be given the **opportunity for price improvement inside the Nasdaq spread based on bids and offers in SelectNet and N-PROVE**. We will integrate these two Nasdaq systems with Nasdaq level one to produce a new superior pricing mechanism for Madoff's clients orders, the Madoff Best Bid and Offer (**MBBO**). In addition, when the level one spread is greater than 1/8 and there are no price improvement opportunities based on resting orders in SelectNet and N-PROVE, **we will stop your order and change our quote in Nasdaq. By tightening the spread we provide your customer with the maximum opportunity for price improvement.** This is the same benefit we currently provide to your customers in listed securities. Our system for enhanced price discovery and price improvement consistently achieves price improvement in listed securities 50% of the time. We expect to achieve similar results with Nasdaq securities and will provide monthly documentation to you of your own firm's results.

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Our efforts to achieve price improvement go significantly beyond what is presently available in the market place today and what N-PROVE will offer in the future. While **Madoff will extend the opportunity for price improvement to every market order**, N-PROVE is limited to 1,000 shares. Madoff also combines SelectNet and N-Prove with level one to define the best price, whereas orders sent to N-Prove will not benefit from interest that may exist in SelectNet. Finally, Madoff will **“stop” your order while tightening the spread** to look for a better price for your customer’s order. N-Prove will not change the quote!

Madoff’s price improvement systems and performance have been acknowledged as the finest in the industry. They are backed up by detailed performance documentation provided to all our clients on a monthly basis. The SEC has requested all market participants to seek price discovery and price improvement through exposure of orders to the marketplace. **Madoff continues to be the only market maker to automatically expose their clients’ orders.**

**Example I - Market Order**

- 1) Nasdaq level one inside quote (best bid and offer) INTC 65x65 1/4
- 2) An order to buy 1,000 shares of INTC at 65 1/8 resides in SelectNet or N-Prove
- 3) New “MBBO” for INTC 65 1/8 x 65 1/4
- 4) Broker/dealer customer sends an order to sell 2,500 shares of INTC at the **market**
- 5) Madoff immediately buys entire 2,500 shares of INTC at 65 1/8

Madoff’s automated systems are programmed to search out and provide the best possible price available for our broker-dealer clients’ customer orders. Since the SelectNet or N-Prove system had a better price than Nasdaq’s inside quotation, Madoff’s system used that price as the appropriate price for the entire **market** order. As with our service for listed securities, we always provide a Fill....**NO PARTIALS**....at the best available price, even though the size at the better price may be significantly less than the size of your customer’s order.

**Example II - Immediately Executable Limit Order**

- 1) Nasdaq level one inside quote (best bid and offer) AAPL 37 1/4 x 37 1/2
- 2) An order to buy 300 AAPL at 37 3/8 resides in SelectNet or N-Prove
- 3) New “MBBO” for AAPL 37 3/8 x 37 1/2
- 4) Broker-dealer customer sends an order to sell 2,000 shares of AAPL at 37 3/8 **limit**
- 5) Madoff immediately buys entire 2,000 shares of AAPL at 37 3/8

Since the SelectNet or N-Prove system had a better price than Nasdaq’s inside quotation, your limit order was immediately executable as defined by the MBBO. Madoff used that bid as the appropriate price for the entire **limit** order. Here again, as with our service for listed securities, we provide a total execution.....**NO PARTIALS**.....at the best price available, even though the size at the better price is significantly less than the size of your customer’s order.



### Example III - Market Order

- 1) Nasdaq level one inside quote (best bid and offer) MSFT 63 3/4 x 64
- 2) No better prices found in SelectNet or N-PROVE systems
- 3) Broker-dealer customer sends an order to buy 3,000 shares of MSFT at the market
- 4) Madoff "**stops**" the entire order of 3,000 shares of MSFT at 64 and our system moves our bid in Nasdaq to 63 7/8.
- 5) New Nasdaq level one inside quote "MBBO" for MSFT 63 7/8 x 64

By bidding for stock at 63 7/8, we attempt to find indications of anyone willing to sell stock lower than 64. This order is **stopped and exposed** to the entire Nasdaq market place. **This quote change stays active for one minute.** If during that one minute any other market maker or broker-dealer hits **any part** of our bid at 63 7/8, we would then execute and sell to our customer the entire 3,000 shares at 63 7/8. This would occur even though we might have bought only 100 shares at 63 7/8. If, however, during that one minute time frame there was no action taken on our bid at 63 7/8, we would execute the 3,000 shares at the 64 stop price.

### Payment for Order Flow/Disclosure

The significance of the opportunity for price improvement offered by Madoff can not be overlooked in light of the disclosure requirements called for in the Securities and Exchange Commission's Payment For Order Flow Final Rule (See release No. 34-34902 p. 7-8 enclosed). The commission held that a statement disclosing whether payment for order flow has been received and whether the customer's order had an opportunity for price improvement will enhance investor protection. Broker-dealers will be required to inform customers in writing whether payment for order flow is received and include "**an explanation of the extent to which unpriced orders can be executed at prices superior to the displayed NBBO at the time the order is received.**"

**We intend to rebate to our customers \$ .02 per share for market orders and immediately marketable limit orders.** Madoff's clients can rest assured and confidently state that their customers' orders will have the highest level of price improvement available in the industry today.



### Limit Orders Exposure

We intend also to offer our broker-dealer clients the best limit order protection that has ever been offered in the Nasdaq market. **We guarantee that we will expose in our quote or immediately execute every one of your customers' limit orders.** As with all limit orders delivered to Madoff, we will guarantee execution of your entire order as soon as we execute the first share.... **No Partial.... We will never buy or sell ahead of your order.**

Recent proposals by both the NASD and the SEC in regards to extension of limit order protection by market makers to customers of other broker-dealers makes no mention of, and does not contemplate any requirement for limit order exposure. Some market makers have responded to this regulatory initiative by offering broker-dealer clients protection to the extent that if they buy stock, they will protect your order. We are offering much more! **We will guarantee to execute or expose each of your customers' orders that equal or better the market.** The SEC has asked all market centers and their participants to reflect their customers' interest in their quote. Only Madoff has done this. **Our system is the only one that exposes orders to all market participants.**

### Example IV-Limit Order

- 1) Nasdaq level one inside quote (best bid and offer) ORCL 41 1/4 x 41 1/2
- 2) No better prices found in SelectNet or N-PROVE systems
- 3) Broker-dealer customer sends an order to sell 2,000 shares of ORCL at 41 3/8
- 4) Madoff's systems automatically changes our quote in Nasdaq to reflect an offering at 41 3/8.
- 5) New Nasdaq level one inside quote for ORCL 41 1/4 x 41 3/8

By offering stock at 41 3/8 in Nasdaq, we give our clients' orders the greatest opportunity for execution possible. If, during that exposure, we sell any stock at 41 3/8, we would then execute and buy our customers' entire 2,000 shares of ORCL at 41 3/8.

**Note:** SelectNet is used as the exposure mechanism for small orders (those less than the required Nasdaq tier size).



We should point out that, as with our practice in listed securities, this superior level of limit order exposure and protection, coupled with our 3,000 shares size guarantees and "NO PARTIALS" policy precludes us from offering rebates on resting limit orders.

These scenarios are just a small sample of the many sophisticated and complex automated mechanisms that we utilize to provide our clients with the greatest potential for superior executions of their customers' orders. We have tried to be responsive to our broker-dealer clients' demands and have invested a great deal of our energy and resources towards that end. We look forward to your participation as an endorsement of our efforts. Your help and support will make this commitment to provide quality execution services the benchmark for the Nasdaq marketplace.

Sincerely,

A handwritten signature in cursive script that reads "Bernard".

Bernard L. Madoff

A handwritten signature in cursive script that reads "Peter".

Peter B. Madoff

PBM/cg  
enclosure



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January 3, 1995

Dear Customer,

Effective Tuesday January 3, 1995 we have made the following changes to our stock list.

ADDING: (10)

ASC - American Stores Inc.  
AZO - Autozone Inc.  
BR - Burlington Resources Inc.  
CCL - Carnival Corp. CL A  
DPS - Dr. Pepper/Seven-Up Cos. Inc.  
EAT - Brinker International Inc.  
MES - Melville Corp.  
MRV - Marvel Entertainment Group Inc.  
ORX - Oryx Energy Co.  
SEG - Seagate Technology Inc.

Thanks,

Debi Taratunio

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**MARKET MAINTAINED IN THE FOLLOWING LISTED SECURITIES**

(\* 19C3 Stocks)

As of: 01/03/95

AA	ALUMINUM COMPANY OF AMERICA	BCE	BCE INC
ABS	ALBERTSONS INC	BDK	BLACK & DECKER CORP
ABT	ABBOTT LABORATORIES	BDX	BECTON DICKINSON & CO
* ABX	AMERICAN BARRICK RESOURCES CRP	* BEL	BELL ATLANTIC CORP
* ACG	ACM GOVERNMENT INCOME FUND INC	BEV	BEVERLY ENTERPRISES
ADI	ANALOG DEVICES	BFI	BROWNING FERRIS INDUSTRIES INC
ADM	ARCHER DANIELS MIDLAND CO	BGE	BALTIMORE GAS & ELECTRIC CO
* ADT	ADT LTD	BHI	BAKER HUGHES INC
AEP	AMERICAN ELECTRIC POWER CO	BK	BANK OF NEW YORK CO INC
AET	AETNA LIFE & CASUALTY CO	BKB	BANK OF BOSTON CORP
AGC	AMERICAN GENERAL CORP	* BLS	BELLSOUTH CORP
* AGN	ALLERGAN INC	BLY	BALLY ENTERTAINMENT CORP
AHC	AMERADA HESS CORP	* BMG	BATTLE MOUNTAIN GOLD CO
AHM	AHMANSON H F & CO	BMY	BRISTOL MYERS SQUIBB CO
AHP	AMERICAN HOME PRODUCTS CORP	BN	BORDEN INC
* AIT	AMERITCH CORP	BNI	BURLINGTON NORTHERN INC
AL	ALCAN ALUMINUM LTD	BOL	BAUSCH & LOMB INC
ALD	ALLIEDSIGNAL INC	BP	BRITISH PETROLEUM CO PLC ADR
* ALL	ALLSTATE CORP	* BR	BURLINGTON RESOURCES INC.
AMB	AMERICAN BRANDS INC	BS	BETHLEHEM STEEL CORP
* AMD	ADVANCED MICRO DEVICES INC	* BTY	BRITISH TELECOMMUN PLC ADR
AMP	AMP INC	* BUD	ANHEUSER BUSCH COS INC
AMR	AMR CORP	C	CHRYSLER CORP
* AMX	ALUMAX INC	* CA	COMPUTER ASSOCIATES INTL INC
AN	AMOCO CORP	CAG	CONAGRA INC
APA	APACHE CORP	CAT	CATERPILLAR INC
ARC	ATLANTIC RICHFIELD CO	CBE	COOPER INDUSTRIES INC
AS	ARMCO INC	CC	CIRCUIT CITY STORES INC
ASC	AMERICAN STORES INC.	CCI	CITICORP
AT	ALLTEL CORP	CCK	CROWN CORK & SEAL CO INC
* ATI	AIRTOUCH COMMUNICATIONS	* CCL	CARNIVAL CORP CL A
AUD	AUTOMATIC DATA PROCESSING INC	* CCR	COUNTRYWIDE CREDIT INDS INC
AVP	AVON PRODUCTS INC	CEN	CERIDIAN CORP
AXP	AMERICAN EXPRESS CO	* CFL	CORESTATES FINANCIAL CORP
AYP	ALLEGHENY POWER SYSTEM INC	CG	COLUMBIA GAS SYSTEM INC
AZA	ALZA CORP	CGP	COASTAL CORP
* AZO	AUTOZONE INC.	CHA	CHAMPION INTERNATIONAL CORP
BA	BOEING CO	CHL	CHEMICAL BANKING CORP
BAC	BANKAMERICA CORP	CHV	CHEVRON CORP
BAX	BAXTER INTERNATIONAL INC	* CHW	CHEMICAL WASTE MANAGEMENT
* BBI	BARNETT BANKS INC	* CI	CIGNA CORP
BC	BRUNSWICK CORP	CIC	CONTINENTAL CORP
BCC	BOISE CASCADE CORP	CIN	CINERGY

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* CIR	CIRCUS CIRCUS ENTERPRISES INC	EMR	EMERSON ELECTRIC CO
* CK	CAREMARK INTERNATIONAL INC	ENE	ENRON CORP
CL	COLGATE PALMOLIVE CO	ENS	ENSERCH CORP
* CMA	COMERICA INC	ETR	ENTERGY CORP
CMB	CHASE MANHATTAN CORP	F	FORD MOTOR CO
CMS	CMS ENERGY CORP	FBO	FEDERAL PAPER BOARD CO
CMY	COMMUNITY PSYCHIATRIC CENTERS	* FD	FEDERATED DEPARTMENT STORES
CNF	CONSOLIDATED FREIGHTWAYS INC	* FFB	FIRST FIDELITY BANCORPORATION
CNG	CONSOLIDATED NATURAL GAS CO	FG	USF & G CORP
CNK	CROMPTON & KNOWLES CORP	FLR	FLUOR CORP
* COL	COLUMBIA/HCA HEALTHCARE CORP	FLT	FLEET FINANCIAL GROUP INC
CPB	CAMPBELL SOUP CO	FNM	FEDERAL NATIONAL MORTGAGE ASSN
CPC	CPC INTERNATIONAL INC	FON	SPRINT CORP
CPL	CAROLINA POWER & LIGHT CO	FPC	FLORIDA PROGRESS CORP
* CPQ	COMPAQ COMPUTER CORP	FPL	FPL GROUP INC
* CRR	CONRAIL INC	* FTL	FRUIT OF THE LOOM INC
CSR	CENTRAL & SOUTH WEST CORP	* FTU	FIRST UNION CORP
CSX	CSX CORP	FTX	FREEPORT MCMORAN INC
CTB	COOPER TIRE & RUBBER CO	G	GILLETTE CO
CX	CENTRIOR ENERGY CORP	* GAB	GABELLI EQUITY TRUST INC
* CYM	CYPRUS AMAX MINERALS CO	GCI	GANNETT CO INC
D	DOMINION RESOURCES INC	GDW	GOLDEN WEST FINANCIAL CORP
DAL	DELTA AIRLINES INC	GE	GENERAL ELECTRIC CO
DD	DU PONT E I DE NEMOURS & CO	GIC	GENERAL INSTRUMENTS CORP
DDS	DILLARD DEPARTMENT STORES INC	GIS	GENERAL MILLS INC
DE	DEERE & CO	* GLD	SANTA FE PACIFIC GOLD CORP
DEC	DIGITAL EQUIPMENT CORP	GLW	CORNING INC
DI	DRESSER INDUSTRIES INC	* GLX	GLAXO HOLDINGS PLC ADR
DIS	THE WALT DISNEY CO	GM	GENERAL MOTORS CORP
DJ	DOW JONES & CO INC	GME	GENERAL MOTORS CORP CLASS E
DL	DIAL CORP	GP	GEORGIA PACIFIC CORP
* DLX	DELUXE CORP	GPC	GENUINE PARTS CO
DNB	DUN & BRADSTREET CORP	GPS	GAP INC
DNY	R R DONNELLEY & SONS CO	GPU	GENERAL PUBLIC UTILITIES CORP
DOW	DOW CHEMICAL CO	GRA	W R GRACE & CO
DPL	DPL INC	* GRM	GRAND METROPOLITAN PLC ADR
* DPS	DR. PEPPER/SEVEN UP COS. INC.	GT	GOODYEAR TIRE & RUBBER CO
DTE	DETROIT EDISON CO	GTE	GTE CORP
DUK	DUKE POWER CO	GWF	GREAT WESTERN FINANCIAL CORP
* DWD	DEAN WITTER DISCOVER & CO	HAL	HALLIBURTON CO
E	TRANSCO ENERGY CO	* HAN	HANSON PLC ADR
* EAT	BRINKER INTERNATIONAL INC.	* HD	HOME DEPOT INC
ECH	ECHLIN INC	* HKT	HONG KONG TELECOM LTD ADR
* ECL	ECOLAB INC	HM	HOMESTAKE MINING CO
ED	CONSOLIDATED EDISON CO OF NY	HMT	HOST MARRIOTT CORP
EK	EASTMAN KODAK CO	HMX	HARTMARX CORP
* ELF	ELF AQUITANE ADR	HNZ	HEINZ H J CO
* EMC	EMC CORP	HON	HONEYWELL INC
* EMN	EASTMAN CHEMICAL CO	HOU	HOUSTON INDUSTRIES INC



HPH	HARNISCHFEGER INDUSTRIES INC	MEA	MEAD CORP
HRB	H & R BLOCK INC	* MEL	MELLON BANK CORP
* HSM	HORSHAM CORP	MER	MERRILL LYNCH & CO INC
* HSN	HOME SHOPPING NETWORK INC	MES	MELVILLE CORP.
* HTI	HEALTHTRUST INC	MHP	MCGRAW HILL INC
HUM	HUMANA INC	MII	MORTON INTERNATIONAL
HWP	HEWLETT PACKARD CO	MKC	MARION MERRELL DOW INC
IBM	INTERNATIONAL BUSINESS MACHS	MKG	MALLINCKRODT GROUP INC
* IBMSA	INTERNATIONAL BUS MACHS PFD A	MMM	MINNESOTA MINING & MFG CO
* IBP	IBP INC	MO	PHILIP MORRIS COS INC
ICI	IMPERIAL CHEMICAL IND PLC ADR	MOB	MOBIL CORP
* IGT	INTERNATIONAL GAME TECHNOLOGY	MOT	MOTOROLA INC
ILN	ILLINOVA CORP	MRK	MERCK & CO INC
IP	INTERNATIONAL PAPER CO	MRO	USX-MARATHON GROUP INC
ITT	ITT CORP	* MRV	MARVEL ENTERTAINMENT GROUP INC
JCP	J C PENNEY CO INC	MTC	MONSANTO CO
JH	JOHN H HARLAND CO	* MXF	MEXICO FUND
JNJ	JOHNSON & JOHNSON	MYG	MAYTAG CORP
JOS	JOSTENS INC	* MYL	MYLAN LABORATORIES
JPM	J P MORGAN & CO INC	N	INCO LTD
* JR	JAMES RIVER CORP OF VIRGINIA	NAV	NAVISTAR INTERNATIONAL CORP
K	KELLOGG CO	* NB	NATIONS BANK CORP
* KBH	KAUFMAN & BROAD HOME CORP	NBD	NBD BANCORP INC
* KEY	KEYCORP	* NCC	NATIONAL CITY CORP
KM	KMART CORP	NEM	NEWMONT MINING CORP
KMB	KIMBERLY CLARK CORP	NGE	NYS ELEC & GAS CORP
KO	COCA COLA CO	* NKE	NIKE INC
KR	KROGER CO	NME	NATIONAL MEDICAL ENTERPRISES
KRB	MBNA CORP	NMK	NIAGARA MOHAWK POWER CORP
KSU	KANSAS CITY SOUTHERN INDS	* NN	NEWBRIDGE NETWORKS CORP
* LA	L A GEAR INC	NOB	NORWEST CORP
LDW.B	LAIDLAW INC	NOC	NORTHROP GRUMMAN CORP
* LEH	LEHMAN BROS HOLDING INC	NSC	NORFOLK SOUTHERN CORP
LIL	LONG ISLAND LIGHTING CO	NSM	NATIONAL SEMICONDUCTOR CORP
* LIZ	LIZ CLAIBORNE INC	NSP	NORTHERN STATES POWER CO
LLY	ELI LILLY & CO	NT	NORTHERN TELECOM LTD
LOR	LORAL CORP	NU	NORTHEAST UTILITIES
LPX	LOUISIANA PACIFIC CORP	* NVA	NOVA CORP
* LTD	THE LIMITED INC	* NWL	NEWELL CO
LTV	LTV CORP	* NWS	NEWS CORP LIMITED
* LUB	LUBYS CAFETERIAS INC	* NYN	NYNEX CORP
LUV	SOUTHWEST AIRLINES CO	OAT	QUAKER OATS CO
MA	MAY DEPARTMENT STORES CO	OCF	OWENS CORNING FIBERGLASS CORP
MAI	M/A COM INC	* ODP	OFFICE DEPOT INC
* MAR	MARRIOTT INTERNATIONAL INC	OEC	OHIO EDISON CO
MAS	MASCO CORP	OG	OGDEN CORP
MAT	MATTEL INC	OKE	ONEOK INC
MCD	MCDONALDS CORP	* ONE	BANC ONE CORP
MDR	MCDERMOTT INTERNATIONAL INC	* ORX	ORYX ENERGY CO.



OXY	OCCIDENTAL PETROLEUM CORP	SHW	SHERWIN WILLIAMS CO
P	PHILLIPS PETROLEUM CO	* SK	SAFETY KLEEN CORP
* PAC	PACIFIC TELESIS GROUP	SLB	SCHLUMBERGER LTD
PBI	PITNEY BOWES INC	SLE	SARA LEE CORP
PBY	PEP BOYS MANNY MOE & JACK	* SLM	STUDENT LOAN MARKETING ASSOC
PCG	PACIFIC GAS & ELECTRIC CO	* SME	SERVICE MERCHANDISE CO INC
* PDG	PLACER DOME INC	SNA	SNAP ON INC
PE	PECO ENERGY CO	* SNC	SHAWMUT NATIONAL CORP
PEG	PUBLIC SERV ENTERPRISE GRP INC	SNT	SONAT INC
PEL	PANHANDLE EASTERN CORP	SO	SOUTHERN CO
PEP	PEPSICO INC	* SPG	SIMON PROPERTY GROUP INC
PET	PACIFIC ENTERPRISES	SPP	SCOTT PAPER CO
PFE	PFIZER INC	SRV	SERVICE CORP INTERNATIONAL
PG	PROCTER & GAMBLE CO	* STI	SUNTRUST BANKS INC
PGN	PORTLAND GENERAL CORP	STO	STONE CONTAINER CORP
* PHG	PHILIPS ELECTRONICS NV ADR	SUN	SUN CO INC
PKN	PERKIN ELMER CORP	SVU	SUPERVALUE INC
PLL	PALL CORP	* SWY	SAFEWAY INC
* PMT	PUTNAM MASTER INCOME TRUST	SYU	SYSCO CORP
* PNC	PNC BANK CORP	T	AT & T CORP
PNM	PUBLIC SERV CO OF NEW MEXICO	TA	TRANSAMERICA CORP
PNW	PINNALE WEST CAPITAL CORP	* TDM	TANDEM COMPUTERS INC
POM	POTOMAC ELECTRIC POWER CO	TDY	TELEDYNE INC
PPL	PENNSYLVANIA POWER & LIGHT CO	TE	TECO ENERGY INC
PPW	PACIFICORP	* TEF	TELEFONICA DE ESPANA SA ADR
PRD	POLAROID CORP	TGT	TENNECO INC
* PT	PET INC	* TIG	TIG HOLDINGS INC
* PX	PRAXAIR INC	TJX	TJX COMPANIES INC
R	RYDER SYSTEM INC	TMC	TIMES MIRROR CO
RAD	RITE AID CORP	* TMX	TELEFONOS DE MEXICO DE CV ADR
* RAH	RALCORP HOLDINGS INC	* TOY	TOYS R US INC
RBD	RUBBERMAID INC	* TRV	TRAVELERS INC
* RBK	REEBOK INTERNATIONAL LTD	TWX	TIME WARNER INC
RD	ROYAL DUTCH PETROLEUM CO	TX	TEXACO INC
RDC	ROWAN COS INC	TXN	TEXAS INSTRUMENTS INC
ROK	ROCKWELL INTERNATIONAL CORP	TXT	TEXTRON INC
S	SEARS ROEBUCK & CO	TXU	TEXAS UTILITIES CO
SB	SALOMON INC	U	USAIR GROUP INC
* SBC	SOUTHWESTERN BELL CORP	UCC	UNION CAMP CORP
* SBE	SMITHKLINE BEECHAM PLC ADR	UCL	UNOCAL CORP DELAWARE
SCE	SCECORP HOLDING CO	UCM	UNICOM CORP
* SCH	CHARLES SCHWAB CORP	UEP	UNION ELECTRIC CO
* SEG	SEAGATE TECHNOLOGY INC	UIS	UNISYS CORP
SFA	SCIENTIFIC ATLANTA INC	UK	UNION CARBIDE CORP
SFR	SANTA FE ENERGY RESOURCES INC	UNP	UNION PACIFIC CORP
SFX	SANTA FE PACIFIC CORP	UPJ	UPJOHN CO
* SGI	SILICON GRAPHICS INC	* USS	U S SURGICAL CORP
SGP	SCHERING PLOUGH CORP	UST	UST INC
* SHN	SHONEYS INC	* USW	US WEST INC



UTX	UNITED TECHNOLOGIES CORP
VO	SEAGRAM CO LTD
WAG	WALGREEN CO
* WB	WACHOVIA CORP
WEC	WISCONSIN ENERGY CORP
* WEL	WELLCOME PLC ADR
* WEN	WENDYS INTERNATIONAL INC
WH	WHITMAN CORP
WLA	WARNER LAMBERT CO
WMB	WILLIAMS COMPANIES INC
WMT	WAL-MART STORES INC
WMX	WMX TECHNOLOGIES INC
* WTI	WHEELABRATOR TECHNOLOGIES
WWY	WM WRIGLEY JR CO
WX	WESTINGHOUSE ELECTRIC CO
WY	WEYERHAEUSER CO
* X	USX-U S STEEL GROUP INC
XON	EXXON CORP
XRX	XEROX CORP
* YPF	YPF SOCIEDAD ANONIMA ADR
Z	WOOLWORTH CORP
Z+A	WOOLWORTH CORP PFD A
ZE	ZENITH ELECTRONICS CORP
* ZTR	ZWEIG TOTAL RETURN FUND INC



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ARSN	Air Sensors Inc. common		Northwest Natural Gas \$2.37 cv. pfd.
ARSNW	Air Sensors Inc. 96 wts.		Norwest Corp. 6 3/4 - 03
	Alltel Corp. \$2.06 cv. pfd.		Ogden Corp. \$1.875 cv. pfd.
ALLEO	Alltel Corp. \$2.25 cv. pfd.		PNC Bank Corp. \$1.60 cv. pfd. C
	American Brands \$2.67 cv. pfd.		PNC Bank Corp. \$1.80 cv. pfd. D
	American Home Prod. \$2.00 cv. pfd.		PNC Financial 8 1/4 - 08
	American Stores 7 1/4 - 01	PARCG	Park Communications 6 7/8 - 11
	Anacomp Inc. 2000 wts.		Pfizer Inc. 4% - 97
	Arrow Electronics 5 3/4-02		Pioneer Financial Svc. \$2.12 cv. pfd.
	Atlantic Richfield \$2.80 cv. pfd.	PBOWP	Pitney Bowes cv. pfd.
	Atlantic Richfield \$3.00 cv. pfd.		Pitney Bowes Inc. \$2.12 cv. pfd.
	Bally Entmt. Corp. \$4.00cv. pfd. D		Plains Resources \$1.30 cv. pfd.
BKNYW	Bank of New York 98 wts.		Potomac Electric Power \$2.44 cv. pfd. 66
	Bank of New York 7 1/2-01		Quanex Corp. cv. exch. pfd.
	Battle Mountain Gold \$3.25 cv. pfd.		Rockwell Intl. \$1.35 cv. pfd. B
	Beneficial Corp. \$5.50 cv. pfd.		Rockwell Intl. \$ 4.75 cv. pfd. A
BORNP	Borden Inc. \$1.32 cv. pfd.		Sea Containers Ltd. \$4.125 cv. pfd.
BOSTG	Boston Chicken Inc. 4 1/2 -04	SBUXG	Starbucks Corp. 4 1/2 - 03
	Bristol-Myers Squibb \$2.00 cv. pfd.		State Street Boston Corp. 7 3/4 - 08
	Cameron Iron Works 7%-12		Sterling Software 5 3/4 -03
	Capstead Mortgage Corp. \$1.60 cv. pfd.A	TFONY	Telefonos De Mexico SA
	Centerpoint Properties 8.22-04		TRW Inc. \$4.40 cv. pfd. series 1
	Central Securities \$2.00 cv.pfd. D		TRW Inc. \$4.50 cv. pfd. series 3
CNAGP	Conagra Corp. \$2.50 cv. pfd.		Tanger Factory Outlet cv. pfd. ser. A
	Consolidated Ed. N.Y. \$6.00 cv. pfd. B		Textron Inc. \$1.40 cv. pfd.
	Deere & Co. 5 1/2-01		Textron Inc. \$2.08 cv. pfd. A
	Detroit Edison 5.50 cv. pfd.		Trimas Corp. 5% - 03
DBRLG	Dibrell Bros. 7 3/4-06		Union Pacific Corp. 4 3/4 - 99
	Elan Corp. PLC 95 wts.		Utilicorp United 6 5/8 - 11
	Enron Corp. \$10.50 cv. 2nd. pfd.		Washington Natl. Corp. \$2.50 cv. pfd.
	Equitable Gas Co. 9 1/2 -06		Wellsford Res. Pty. cv. pfd. A
	Federal Paper Bd. \$1.20 cv. pfd.		Western Digital Corp. 9% - 14
	Federal Paper Bd. \$2.875 cv. pfd.		Wheeling Pittsburgh Corp. 96 wts.
FVBIP	First Virginia Bank 5 pfd. A	ZMEXW	Zemex Corp. 95 wts.
	Gatx Corp. \$2.50 cv. pfd.		
	GTE Corp. \$2.00 cv. pfd.		
	GTE Corp. \$5.00 cv. pfd.		
	General Instrument 5%-00		
	Harcourt General cv. pfd. A		
	Hercules Inc. 6 1/2 - 99		
	Hazleton Labs. 6 1/2-06		
	Hercules Inc. 8%-19		
	H.J. Heinz Co. \$1.70 3rd cv.pfd.		
	Household Intl. \$6.25 vtg. cv. pfd.		
	ITT Corp. \$2.25 cv. pfd. N		
	Inland Steel Ind. \$2.40 cv. pfd. A		
	J.P. Morgan & Co. 4 3/4-98		
	Kellwood Co. 9%-99		
	Liebert Corp. 8%-10		
	Mediq Inc. cv. pfd. A		
	Merry Land & Invstmt. \$1.75 cv. pfd. A		
	National Health Investors \$8.50 cv. pfd.		
	National Health Investors 10%-06		
	Navistar Intl. cv. pfd. D		

Affiliated with:

Madoff Securities International Ltd.

43 London Wall, London England EC2M 5TB.071-374 0891



**BERNARD L. MADOFF**  
**Investment Securities**

885 Third Avenue New York, NY 10022-4834

212 230-2424  
800 334-1343  
Telex 235130  
Fax 212 486-8178

**MARKET MAINTAINED IN THE FOLLOWING NASDAQ SECURITIES**  
**(\*NMS SECURITIES)**

As of: 1/3/95

*AAPL	APPLE COMPUTER INC.
*AKLM	ACCLAIM ENTERTAINMENT INC.
*AMGN	AMGEN INC.
*APCC	AMERICAN POWER CONVERSION
*ASTA	AST RESEARCH INC.
*BNET	BAY NETWORKS INC.
*BOST	BOSTON CHICKEN INC.
*CADBY	CADBURY SCHWEPPES PLC ADR
*CALL	NEXTEL COMMUNICATIONS INC.
*CMCSA	COMCAST CORP. CL. A
*CMCSK	COMCAST CORP. SPECIAL CL. A
*CMIC	CALIFORNIA MICROWAVE
*CSCO	CISCO SYSTEMS INC.
*DANKY	DANKA BUSINESS SYSTEMS PLC ADR
*DIGI	DSC COMMUNICATIONS CORP.
DRFNY	DRIEFONTEIN CONSOLIDATED LIMITED ADR
*ERICY	L.M. ERICSSON TELEPHONE CO. ADR
*ERTS	ELECTRONIC ARTS INC.
*FDLNA	FOOD LION INC. CL. A
*FDLNB	FOOD LION INC. CL. B
FSCNY	FREE STATE CONSOLIDATED GOLD MINES LTD. ADR
*IDTI	INTEGRATED DEVICE TECHNOLOGY INC.
*INTC	INTEL CORP.
*INTCW	INTEL CORP. 98 WTS.
KLOFY	KLOOF GOLD MINING CO. LTD ADR
*LOTS	LOTUS DEVELOPMENT CORP.
*MCIC	MCI COMMUNICATIONS CORP.
*MSFT	MICROSOFT CORP.
*NOVL	NOVELL INC.
*ORCL	ORACLE SYSTEMS CORP.
*PCCW	PRICE/COSTCO INC.
*PGSAY	PETROLEUM GEO SERVICES ADR
*QNTM	QUANTUM CORP.
*RTRSY	REUTERS HOLDINGS PLC ADR
*SBUX	STARBUCKS CORP.
*SPLS	STAPLES INC.
*SUNW	SUN MICROSYSTEMS INC.
*TCOMA	TELE-COMMUNICATIONS CL. A
*TEVIY	TEVA PHARMACEUTICAL INDUSTRIES LTD. ADR
VAALY	VAAL REEFS EXPLORATION & MINING CO. LTD ADR

Affiliated with:

Madoff Securities International Ltd.  
43 London Wall, London England EC2M 5TB.071-374 0891

MADOFF\_EXHIBITS-05415

whether a firm is meeting its obligation of best execution to its customer. Not all market centers expose market orders to other order flow or attempt to improve the price at which market orders are executed. Thus, the decision to route an unpriced order to a market center offering immediate execution at the NBBO, could mean that the customer has lost an opportunity for execution at a superior price because of the lack of exposure to other order flow.<sup>14</sup> For the reasons discussed below, the Commission believes disclosure that payment for order flow has been received and a description of whether the customer's order has an opportunity for price improvement will enhance investor protection and provide customers with information to evaluate more effectively the markets to which their orders are routed.

### III. Discussion

The Rules adopted today represent a tiered approach to disclosure of payment for order flow practices in the broader context of broker-dealer order handling practices and the special relationship that already exists between a broker-dealer and its customer.<sup>15</sup> The components of the Rules include disclosure at

<sup>14</sup> See Market 2000, supra note 3, Study V at 3-4.

<sup>15</sup> A broker-dealer's duty to seek to obtain best execution of customer orders derives, in part, from the common law agency duty of loyalty, which obligates an agent to act exclusively in the principal's best interest. Restatement 2d Agency § 387 (1958). Thus, when an agent acts on behalf of a customer in a transaction, the agent is under a duty to exercise reasonable care to obtain the most advantageous terms for the customer. Restatement 2d Agency § 424 (1958).

the time an account is opened, annually thereafter, and on the transaction confirmation.

First, the Rules adopted today require broker-dealers to inform customers in writing, when a new account is opened, about the dealer's policies regarding the receipt of payment for order flow, including whether payment for order flow is received; and a detailed description of the nature of the compensation received.

As discussed in greater detail below, the new Rule and Rule amendments require that broker-dealers provide information in account opening documents about order routing decisions in orders subject to payment for order flow, including an explanation of the extent to which unpriced orders can be executed at prices superior to the displayed NBBO at the time the order is received.

Second, the Rules adopted today require dealers to update this information and to provide such information annually to all customers. Taken together, this information should assist customers in assessing the quality of trade executions they receive and encourage broker-dealers to consider the opportunity for price improvement in establishing order routing arrangements. Finally, the Rules adopted today require broker-dealers to indicate on confirmations whether the broker or dealer receives payment for order flow, and the availability of further information on request. These are described in greater detail below, beginning with the scope of securities subject to the Rules and the types of inducements covered by the Rules.

\*\*\*\*\*  
OFFICE OF THE CHAIRMAN  
\*\*\*\*\*

DATE ASSIGNED : 01/09/95 CONTROL #: 062344  
DATE OF CORRES.: 01/05/95 MASTER #: 0000232119  
DATE DUE : 01/17/95

ASSIGNED TO: MR BECKER  
ACTION REQUIRED: PREPARE RESPONSE FOR CHAIRMAN'S SIGNATURE  
CORRESPONDENT: PETER B. MADOFF  
ORGANIZATION: BERNARD L. MADOFF INVESTMENT SECURITIES  
CONSTITUENT: \_\_\_\_\_  
SUBJECT: ANNOUNCEMENT TO CLIENTS RE NASDAQ INITIATIVES

SPECIAL INSTRUCTIONS: \_\_\_\_\_  
COPIES TO: LEVITT RICHARDS DWYER

\*\*\*\*\*  
COMPLETE THIS SECTION AND RETURN TO EXECUTIVE CORRESPONDENCE  
ASSISTANT, OFFICE OF THE CHAIRMAN, ROOM 6010, STOP 6-1  
\*\*\*\*\*

DRAFTED BY: DAVID DEITSCHER PHONE: 942-0173  
DIVISION DIRECTOR APPROVAL: [Signature] DATE: 1/11/95  
COMMENTS: \_\_\_\_\_

\*\*\*\*\*  
CHAIRMAN'S OFFICE REVIEW  
LEGISLATIVE AFFAIRS: \_\_\_\_\_ DATE: \_\_\_\_\_  
CHAIRMAN'S OFFICE: [Signature] DATE: 1/11/95  
COMMENTS/CHANGES: \_\_\_\_\_

[Signature] [Signature] 01/11/95

**BERNARD L. MADOFF**  
**Investment Securities**

885 Third Avenue New York, NY 10022

212 230-2424  
800 221-2242  
Telex 235130  
Fax 212 486-8178

Bernard L. Madoff

November 14, 1995

Chairman Arthur Levitt  
U.S. Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

066309  
RECEIVED  
95 NOV 20 PM 1:49  
OFFICE OF THE CHAIRMAN

Dear Arthur,

I know it sounds self-serving to compliment a speech that acknowledges our firm's recent efforts in price improvement and limit order exposure. Peter and I walked around for days basking in a warm glow.

Our personal interest aside, I am certain that I express the opinion of the entire securities industry by stating that we have never heard more thoughtful and upbeat remarks that made us all feel confident about the future.

It was fun having dinner and I would love to do some sail and marlin fishing with you if you ever find yourself in Palm Beach. Personal Privacy

Regards,

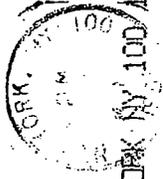
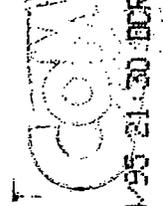
*Bernard L. Madoff*  
11

BLM/ep

Affiliated with:  
Madoff Securities International Ltd.  
43 London Wall, London England EC2M 5TB.01-374 0891

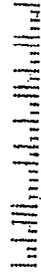
**BERNARD L. MADOFF**  
**Investment Securities**

885 Third Avenue New York, NY 10022



NEW YORK NY 100 11/14/95 21:30 ED

CHAIRMAN ARTHUR LEVITT  
U.S. SECURITIES AND EXCHANGE  
COMMISSION  
450 FIFTH STREET, N.W.  
WASHINGTON, DC 20549





THE CHAIRMAN

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

January 19, 1995

Mr. Bernard L. Madoff  
Mr. Peter B. Madoff  
Bernard L. Madoff Investment Securities  
885 Third Avenue  
New York, NY 10022-4834

Dear Bernie and Peter:

Thanks for your letter of January 5, 1995. I was interested to learn that you have extended your services to Nasdaq securities.

As always, I appreciate you keeping me informed of new developments. Thanks again and best wishes for a healthy new year.

Sincerely,

  
Arthur Levitt

\*\*\*\*\*  
OFFICE OF THE CHAIRMAN  
\*\*\*\*\*

DATE ASSIGNED : 11/20/95 CONTROL #: 066309  
DATE OF CORRES: 11/14/95 MASTER #: 0000328464  
DATE DUE :  / /

ASSIGNED TO: ES FILES  
ACTION REQUIRED: FOR YOUR INFORMATION

CORRESPONDENT: BERNARD L. MADOFF

ORGANIZATION: \_\_\_\_\_

CONSTITUENT: \_\_\_\_\_

SUBJECT: ENJOYED RECENT SPEECH

SPECIAL INSTRUCTIONS: \_\_\_\_\_

COPIES TO: LEVITT SCHLEIN

\*\*\*\*\*  
COMPLETE THIS SECTION AND RETURN TO EXECUTIVE CORRESPONDENCE  
ASSISTANT, OFFICE OF THE CHAIRMAN, ROOM 6010, STOP 6-1  
\*\*\*\*\*

DRAFTED BY: \_\_\_\_\_ PHONE: \_\_\_\_\_

DIVISION DIRECTOR APPROVAL: \_\_\_\_\_ DATE: \_\_\_\_\_

COMMENTS: \_\_\_\_\_

\*\*\*\*\*  
CHAIRMAN'S OFFICE REVIEW  
\*\*\*\*\*

LEGISLATIVE AFFAIRS: \_\_\_\_\_ DATE: \_\_\_\_\_

CHAIRMAN'S OFFICE: \_\_\_\_\_ DATE: \_\_\_\_\_

COMMENTS/CHANGES: \_\_\_\_\_

*11/20*

OFFICE OF THE CHAIRMAN

DATE ASSIGNED : 01/22/97

CONTROL #: 070703

DATE OF CORRES. : 01/22/97

MASTER #: 0000395550

DATE DUE : 1/1

ASSIGNED TO: MR LINDSEY

ACTION REQUIRED: PROPER DISPOSITION

CORRESPONDENT: BERNARD L. MADOFF

ORGANIZATION: SIA

CONSTITUENT: \_\_\_\_\_

SUBJECT: CC LTR TO MR/LINDSEY RE ORDER HANDLING RULES

SPECIAL INSTRUCTIONS: \_\_\_\_\_

COPIES TO: LEVITT

SCARDINO

TELLINI

\*\*\*\*\*  
COMPLETE THIS SECTION AND RETURN TO EXECUTIVE CORRESPONDENCE  
ASSISTANT, OFFICE OF THE CHAIRMAN, ROOM 6010, STOP 6-1  
\*\*\*\*\*

DRAFTED BY: \_\_\_\_\_

PHONE: \_\_\_\_\_

DIVISION DIRECTOR APPROVAL: MAO

DATE: 1-23-97

COMMENTS: NRN, but copies to Rolby, Kramer, Tellini, D. Oestreich, B. Pritz-Lefty, G. Marshall

CHAIRMAN'S OFFICE REVIEW

LEGISLATIVE AFFAIRS: \_\_\_\_\_

DATE: \_\_\_\_\_

CHAIRMAN'S OFFICE: \_\_\_\_\_

DATE: \_\_\_\_\_

COMMENTS/CHANGES: \_\_\_\_\_

\*\*\*\*\*  
OFFICE OF THE CHAIRMAN  
\*\*\*\*\*

DATE ASSIGNED : 01/22/97 CONTROL #: 070703  
DATE OF CORRES.: 01/22/97 MASTER #: 0000395550  
DATE DUE :  / /

ASSIGNED TO: MR LINDSEY

ACTION REQUIRED: PROPER DISPOSITION

CORRESPONDENT: BERNARD L. MADOFF

ORGANIZATION: SIA

CONSTITUENT: \_\_\_\_\_

SUBJECT: CC LTR TO MR/LINDSEY RE ORDER HANDLING RULES

SPECIAL INSTRUCTIONS: \_\_\_\_\_

COPIES TO: LEVITT SCARDINO TELLINI \_\_\_\_\_  
\_\_\_\_\_

\*\*\*\*\*  
COMPLETE THIS SECTION AND RETURN TO EXECUTIVE CORRESPONDENCE  
ASSISTANT, OFFICE OF THE CHAIRMAN, ROOM 6010, STOP 6-1  
\*\*\*\*\*

DRAFTED BY: \_\_\_\_\_ PHONE: \_\_\_\_\_

DIVISION DIRECTOR APPROVAL: \_\_\_\_\_ DATE: \_\_\_\_\_

COMMENTS: \_\_\_\_\_

\*\*\*\*\*  
CHAIRMAN'S OFFICE REVIEW

LEGISLATIVE AFFAIRS: \_\_\_\_\_ DATE: \_\_\_\_\_

CHAIRMAN'S OFFICE: \_\_\_\_\_ DATE: \_\_\_\_\_

COMMENTS/CHANGES:



**Securities Industry Association**

1401 Eye Street, NW • Washington, DC 20005-2225 • (202) 296-9410 • Fax (202) 296-9775

January 22, 1997

Richard R. Lindsey  
Director  
Division of Market Regulation  
U.S. Securities and Exchange Commission  
450 Fifth Street, NW  
Washington, DC 20549

RECEIVED  
070783  
97 JAN 22 PM 3:28  
OFFICE OF THE CHAIRMAN

Dear Mr. Lindsey,

The Securities Industry Association (“SIA”) appreciates the Securities and Exchange Commission’s (“SEC”) recent action approving a number of regulatory and systems changes by the National Association of Securities Dealers, Inc. (“NASD”) relating to implementation of the SEC’s order handling rules. The changes include a 3-month pilot during which Nasdaq market makers will be able to quote minimum share sizes of at least 100 shares when they are not displaying customer limit orders.<sup>1</sup>

As you know, the SIA’s Trading Committee (“Committee”) strongly supports the proposed changes.<sup>2</sup> The Committee believes that the display of customer limit orders and orders placed in electronic communications networks (“ECNs”) adds significant new sources of liquidity to the Nasdaq market, and that mandatory quote size requirements are therefore unnecessary. Nevertheless, we believe the pilot will provide an opportunity to assess the impact of the rule change on the market.

The Trading Committee will vigorously monitor the pilot, which will begin on January 20 and will apply to the 50 stocks subject to the Limit Order Display Rule as of that date. If the rule change has a negative impact on liquidity in the Nasdaq market, the Committee will report to the Commission and may recommend that the NASD impose some greater minimum quote size requirement.

<sup>1</sup> Currently, the NASD requires market makers to quote minimum sizes ranging from 200 to 1000 shares, depending on the security.

<sup>2</sup> See Letter to Jonathan G. Katz, Secretary, Securities and Exchange Commission, from Bernard L. Madoff, Chairman, SIA Trading Committee, dated December 26, 1996.

We look forward to working with you during the phase-in of these important new rules. If you have any questions, please contact the undersigned, or Judith Poppalardo, SIA Assistant General Counsel, at (202) 296-9410.

Sincerely,

A handwritten signature in black ink, appearing to read "B. Madoff", written over a horizontal line.

Bernard L. Madoff  
Chairman  
Trading Committee

CC: Chairman Arthur Levitt  
Commissioner Steven M.H. Wallman  
Commissioner Norman S. Johnson  
Commissioner Isaac C. Hunt, Jr.

OFFICE OF THE CHAIRMAN

DATE ASSIGNED : 02/11/97  
DATE OF CORRES. : 01/30/97  
DATE DUE : / /

CONTROL #: 070966  
MASTER #: 0000398799

ASSIGNED TO: MR LINDSEY

ACTION REQUIRED: PROPER DISPOSITION

CORRESPONDENT: BERNARD L. MADOFF

ORGANIZATION:

CONSTITUENT:

SUBJECT: LTR TO LINDSEY RE ORDER HANDLING RULES

SPECIAL INSTRUCTIONS:

COPIES TO: LEVITT SCARDINO TELLINI

\*\*\*\*\*  
COMPLETE THIS SECTION AND RETURN TO EXECUTIVE CORRESPONDENCE  
ASSISTANT, OFFICE OF THE CHAIRMAN, ROOM 6010, STOP 6-1  
\*\*\*\*\*

DRAFTED BY: \_\_\_\_\_ PHONE: \_\_\_\_\_

DIVISION DIRECTOR APPROVAL: MAD DATE: 2-13-97

COMMENTS: NRN per Kramer's instructions

CHAIRMAN'S OFFICE REVIEW

LEGISLATIVE AFFAIRS: \_\_\_\_\_ DATE: \_\_\_\_\_

CHAIRMAN'S OFFICE: \_\_\_\_\_ DATE: \_\_\_\_\_

COMMENTS/CHANGES:

Code: C  
Due: 3/4  
To: Kramer

\*\*\*\*\*  
OFFICE OF THE CHAIRMAN  
\*\*\*\*\*

DATE ASSIGNED : 02/11/97 CONTROL #: 070966  
DATE OF CORRES.: 01/30/97 MASTER #: 0000398799  
DATE DUE :  / /

ASSIGNED TO: MR LINDSEY

ACTION REQUIRED: PROPER DISPOSITION

CORRESPONDENT: BERNARD L. MADOFF

ORGANIZATION: \_\_\_\_\_

CONSTITUENT: \_\_\_\_\_

SUBJECT: LTR TO LINDSEY RE ORDER HANDLING RULES

SPECIAL INSTRUCTIONS: \_\_\_\_\_

COPIES TO: LEVITT SCARDINO TELLINI \_\_\_\_\_

\*\*\*\*\*  
COMPLETE THIS SECTION AND RETURN TO EXECUTIVE CORRESPONDENCE  
ASSISTANT, OFFICE OF THE CHAIRMAN, ROOM 6010, STOP 6-1  
\*\*\*\*\*

DRAFTED BY: \_\_\_\_\_ PHONE: \_\_\_\_\_

DIVISION DIRECTOR APPROVAL: \_\_\_\_\_ DATE: \_\_\_\_\_

COMMENTS: \_\_\_\_\_

\*\*\*\*\*  
CHAIRMAN'S OFFICE REVIEW

LEGISLATIVE AFFAIRS: \_\_\_\_\_ DATE: \_\_\_\_\_

CHAIRMAN'S OFFICE: \_\_\_\_\_ DATE: \_\_\_\_\_

COMMENTS/CHANGES:

more limited basis will ensure that the rules are implemented in a responsible manner with the least chance of disruption to the market. Therefore, the Committee urges the Commission to consider extending the established implementation schedule in order to accommodate the phase-in approach proposed above. We believe such an approach would be prudent given the dramatic changes that the rules entail.

We thank you for your consideration of this matter and will continue to work with you to ensure the orderly implementation of these rules. If you would like to discuss this further, please contact me at your convenience.

Sincerely,

A handwritten signature in black ink, appearing to read "Bernard L. Madoff". The signature is stylized and somewhat cursive, with a prominent initial "B" and a long, sweeping underline.

Bernard L. Madoff  
Chairman  
Trading Committee

CC: Chairman Arthur Levitt  
Commissioner Steven M.H. Wallman  
Commissioner Norman S. Johnson  
Commissioner Isaac C. Hunt, Jr.

\*\*\*\*\*  
OFFICE OF THE CHAIRMAN  
\*\*\*\*\*

DATE ASSIGNED : 05/02/97

CONTROL #: 071924

DATE OF CORRES.: 04/28/97

MASTER #: 0000411648

DATE DUE : 05/07/97

ASSIGNED TO: MR LINDSEY

ACTION REQUIRED: PREPARE RESPONSE FOR CHAIRMAN'S SIGNATURE

CORRESPONDENT: BERNARD MADOFF

ORGANIZATION: \_\_\_\_\_

CONSTITUENT: \_\_\_\_\_

SUBJECT: CONCERNS POSTING QUOTATIONS IN NYSE SECURITIES

SPECIAL INSTRUCTIONS: \_\_\_\_\_

COPIES TO: LEVITT

SCARDINO

TELLINI

\*\*\*\*\*  
COMPLETE THIS SECTION AND RETURN TO EXECUTIVE CORRESPONDENCE  
ASSISTANT, OFFICE OF THE CHAIRMAN, ROOM 6010, STOP 6-1  
\*\*\*\*\*

DRAFTED BY: T. Pecora

PHONE: X-0183

DIVISION DIRECTOR APPROVAL: M. Ho

DATE: 5-6-97

COMMENTS: \_\_\_\_\_

*5/12 to Chairman's office of charge noted. Per T. Pecora. UAR. 5/12/97*

\*\*\*\*\*  
CHAIRMAN'S OFFICE REVIEW  
\*\*\*\*\*

LEGISLATIVE AFFAIRS: \_\_\_\_\_

DATE: \_\_\_\_\_

CHAIRMAN'S OFFICE: \_\_\_\_\_

DATE: 5/6 5/12

COMMENTS/CHANGES: \_\_\_\_\_

*Comments - GUC 5/8*

*RIJ MR - 5/12*

\*\*\*\*\*  
OFFICE OF THE CHAIRMAN  
\*\*\*\*\*

DATE ASSIGNED : 05/02/97 CONTROL #: 071924  
DATE OF CORRES.: 04/28/97 MASTER #: 0000411648  
DATE DUE : 05/07/97

ASSIGNED TO: MR LINDSEY

ACTION REQUIRED: PREPARE RESPONSE FOR CHAIRMAN'S SIGNATURE

CORRESPONDENT: BERNARD MADOFF

ORGANIZATION: \_\_\_\_\_

CONSTITUENT: \_\_\_\_\_

SUBJECT: CONCERNS POSTING QUOTATIONS IN NYSE SECURITIES

SPECIAL INSTRUCTIONS: \_\_\_\_\_

COPIES TO: LEVITT SCARDINO TELLINI  
\_\_\_\_\_  
\_\_\_\_\_

\*\*\*\*\*  
COMPLETE THIS SECTION AND RETURN TO EXECUTIVE CORRESPONDENCE  
ASSISTANT, OFFICE OF THE CHAIRMAN, ROOM 6010, STOP 6-1  
\*\*\*\*\*

DRAFTED BY: \_\_\_\_\_ PHONE: \_\_\_\_\_

DIVISION DIRECTOR APPROVAL: \_\_\_\_\_ DATE: \_\_\_\_\_

COMMENTS: \_\_\_\_\_

\*\*\*\*\*  
CHAIRMAN'S OFFICE REVIEW

LEGISLATIVE AFFAIRS: \_\_\_\_\_ DATE: \_\_\_\_\_

CHAIRMAN'S OFFICE: \_\_\_\_\_ DATE: \_\_\_\_\_

COMMENTS/CHANGES:



**BERNARD L. MADOFF**  
**Investment Securities**

885 Third Avenue New York, NY 10022-4834

212 230-2424  
800 334-1343  
Telex 235130  
Fax 212 486-8178

07/924  
**RECEIVED**

April 28, 1997  
97 APR 30 AM 11:17

OFFICE OF THE CHAIRMAN

Arthur J. Levitt, Jr.  
U.S. Securities and Exchange Commission  
450 5th Avenue  
Washington, DC 20549

Dear Arthur,

The Securities Acts of 1975 require transparency, competition and technical means for achieving the intent of Congress to provide specialist quotations which reflect the investor interest to the

For many years for quotations in NYSE securities with 1/8 increment has System (ITS) as securities. SEC competitive market pricing criteria.

**On Monday** quotation increments and spreads and reduce additional interest for our customers' market traditional standards of execution quality and service schedule.

Jennifer - 5/7

I'm covering for Mark

on this letter. Has AL

Gregg - gone as far (publicly) as that

but I the 2nd P

consolidate into one

as still done - this is

a courtesy response anyway so

no point in taking a risk

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o attract

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er  
e

Bernard L. Madoff Investment Securities is a beneficiary of National Market System competition. We appreciate the opportunity to compete for your business.

Sincerely,

Sincerely,

Bernard L. Madoff

Peter B. Madoff

Affiliated with:

Madoff Securities International Ltd.

43 London Wall, London England EC2M 5TB.071-374 0891

\*\*\*\*\*  
OFFICE OF THE CHAIRMAN  
\*\*\*\*\*

DATE ASSIGNED : 03/24/98 CONTROL #: 075314

DATE OF CORRES.: 03/20/98 MASTER #: 0000463656

DATE DUE :  / /

ASSIGNED TO: OS KATZ

ACTION REQUIRED: PROPER DISPOSITION

CORRESPONDENT: BERNARD L. MADOFF

ORGANIZATION: BERNARD L. MADOFF INVESTMENT SECURITIES

CONSTITUENT: \_\_\_\_\_

SUBJECT: COMMENTS RE SR-NASD-98-17 RE LIMIT ORDER BOOK

SPECIAL INSTRUCTIONS: MARCH 19TH COMMENT LTR FORWARDED TO OS/KATZ

COPIES TO: LEVITT SCARDINO LINDSEY BLAINE

RICHARDS \_\_\_\_\_

\*\*\*\*\*  
COMPLETE THIS SECTION AND RETURN TO EXECUTIVE CORRESPONDENCE  
ASSISTANT, OFFICE OF THE CHAIRMAN, ROOM 6010, STOP 6-1  
\*\*\*\*\*

DRAFTED BY: \_\_\_\_\_ PHONE: \_\_\_\_\_

DIVISION DIRECTOR APPROVAL: \_\_\_\_\_ DATE: \_\_\_\_\_

COMMENTS: \_\_\_\_\_

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CHAIRMAN'S OFFICE REVIEW

LEGISLATIVE AFFAIRS: \_\_\_\_\_ DATE: \_\_\_\_\_

CHAIRMAN'S OFFICE: \_\_\_\_\_ DATE: \_\_\_\_\_

COMMENTS/CHANGES:

**BERNARD L. MADOFF**  
**Investment Securities**  
885 Third Avenue New York, NY 10022

212 230-2424  
800 221-2242  
Telex 235130  
Fax 212 486-8178

Bernard L. Madoff

March 20, 1998

Arthur J. Levitt, Jr.  
Chairman  
U.S. Securities and Exchange Commission  
450 5<sup>th</sup> Street, N.W.  
Washington, D.C. 20549

Dear Arthur,

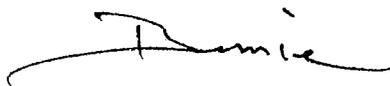
The attached comment letter dealing with the NASD filing on its limit order book is one of the most difficult and important letters my brother and I have had to write.

You and I believe that the best way to deal with these types of issues is by building a consensus through negotiation and compromise.

This approach worked very well on other projects of mutual importance to the commission and the industry, such as the Order Handling Rules and OATS, where I was able to negotiate an agreement that was acceptable to all parties. Unfortunately, the compromise that I structured for the NASD "limit order book" which was acceptable to the trading community as well as the SIA, was unacceptable to the NASD.

That being said, I am willing to let the chips fall where they may and continue to use my best efforts on other issues as they arise.

Sincerely,



BLM/ep

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OFFICE OF THE CHAIRMAN

Affiliated with:  
Madoff Securities International Ltd.  
43 London Wall, London England EC2M 5TB.01-374 0891

MADOFF\_EXHIBITS-05434

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**Investment Securities**  
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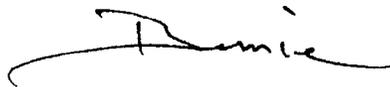
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MADOFF\_EXHIBITS-05435

**BERNARD L. MADOFF**  
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March 19, 1998

Arthur J. Levitt, Jr.  
Chairman  
Securities and Exchange Commission  
450 Fifth Street, NW  
Washington, DC 20549

Re: File #SR-NASD-98-17

Dear Chairman Levitt:

Bernard L. Madoff Investment Securities ("Madoff") is pleased to comment on the Nasdaq Stock Market Inc.'s new integrated order delivery and execution system ("System"). Madoff has been a market maker for over 37 years and is proud to have been a pilot firm and one of the original participants in the first Nasdaq system. We have enthusiastically supported and participated in virtually every Nasdaq pilot and system related to our market making activities. Over the years we have witnessed significant change within the Nasdaq marketplace. Many of the changes were revolutionary as well as evolutionary enhancements brought about by Nasdaq's commitment to the use of technology as one of the building blocks of our marketplace. Nasdaq also brought about change by implementing rules that increased transparency and investor confidence by demanding timely as well as accurate quote and trade data. All of these changes were predicated and contingent upon active and enthusiastic market maker participation. Without market maker support and commitment of their capital to the dealer market, Nasdaq would not be the successful marketplace it is today.

Nasdaq's proposed new integrated order delivery and execution system would replace and correct serious inequities prevalent in prior Nasdaq systems, notably the dual liability for market makers as the result of two distinct Nasdaq execution and order delivery systems (SOES and SelectNet). It also offers exciting new benefits such as automatic execution and expanded access for market makers, proprietary broker-dealers and sponsored institutions, along with virtually unlimited size of order entry. We enthusiastically support these proposals as well as the Nasdaq stipulated caveat that some of these enhancements must be conditioned upon the Securities and Exchange Commission's ("SEC") long overdue acceptance and extension of Nasdaq market makers' right to use "Actual Size" rather than an artificial minimum quote size for all Nasdaq National Market System ("NMS") quotations.

Affiliated with:

Madoff Securities International Ltd.

43 London Wall, London England EC2M 5TB.071-374 0891

MADOFF\_EXHIBITS-05436

**Nasdaq must also include marketwide “trade-through” protection as a fundamental component of its proposed new system**

We would strongly suggest that the Nasdaq Stock Market consider amending its proposal to include a comprehensive “Trade-Through Rule” which would ensure that all exposed interest<sup>1</sup> displayed on Nasdaq’s System would not be traded through. The SEC’s Order Handling Rules have accomplished a great deal in terms of enhancing transparency in our marketplace and helping to more clearly define a price discovery mechanism that provides benefits from that transparency for all market participants. The implementation of such a rule would take the SEC Order Handling Rules one step further. It would add even more credibility to the Nasdaq marketplace and its commitment to protect the interest displayed in the new Nasdaq System. It would provide more certainty of execution and encourage greater display of size by all Nasdaq market participants.

The rule should not allow inferior priced trades to be reported in the Nasdaq marketplace without a prior commitment to satisfy all better priced displayed interest residing in the System. Trade-through satisfaction need only be extended to displayed size. It should not extend to reserve or supplemental size or to those orders withheld from display as proscribed by both the Order Handling and Nasdaq Rules.

The new System’s proposed “takeout” facility would provide a simple, easily accessible mechanism to assure “Trade-Through Rule” compliance. It would establish documented delivery to all displayed quotations along with automatic execution which would ensure a timely response as dictated by the SEC’s Firm Quote (Rule 11Ac1-1) obligations. Because there would be no protection for undisplayed orders or market makers’ supplemental size, the “Trade-Through Rule” would encourage transparency by putting the burden of risk on those participants who choose not to display some or all of their interest.

**Nasdaq’s proposal for a separate and distinct Nasdaq Limit Order File would be a significant burden on competition**

Nasdaq’s proposal for a new integrated order delivery and execution system presents a unique and vexing problem for us as well as all Nasdaq market makers. The proposed System would feature what Nasdaq has characterized as a voluntary limit order book (“Limit Order File” or “File”) that would allow NASD members and Sponsored Participants to enter and display anonymous limit orders without the need for representation in a market maker’s quotation. For the first time the Nasdaq Stock Market is choosing to structure a system that obviates the need for market makers and their quotations as a necessary component of the marketplace.

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<sup>1</sup> exposed interest includes all qualified System market makers, Electronic Communication Networks (ECN’s) and Unlisted Trading Privilege (UTP) Exchange quotations as well as customer and proprietary broker-dealer orders displayed in the system.

The NASD and Nasdaq Boards stated **“...in authorizing this rule filing agreed that the NASD had no intention to create a regulatory environment that would mandate NASD member use of the Limit Order File....”** Nor would it **“...require members to protect orders in the Limit Order File beyond the members best execution obligations. The new Limit Order File would simply be an additional means for members and their customers to display priced orders to the entire market. Thus the proposed File merely provides another option for displaying orders and is intended to supplement, not supplant, the existing options, i.e., a market maker’s quotation....”**

The NASD has also stated that its limit order initiative is consistent with Section 11A(a)(1)(C)(5) of the Act, which provides for **“.... an opportunity for investor orders to be executed without the participation of a dealer.”** It is ironic that the NASD and Nasdaq Boards, both of whom are charged with oversight and operation of broker-dealers as well as the Nasdaq dealer marketplace, have chosen to posture their creation of a Limit Order File on a statement of congressional intent that may no longer be relevant or appropriate in view of the SEC’s Order Handling Rules and Nasdaq’s Manning interpretations.<sup>2</sup> These rules have effectively mandated that Nasdaq dealers may not benefit from a dealer spread while representing customer limit orders. However, we believe that the ‘75 Acts and SEC 11A(a)(1)(C)(5) did not intend to deprive broker-dealers or market makers of the opportunity to represent limit orders as an agent/riskless principal for which they may be entitled to charge a fee if not a dealer spread.

It is unrealistic for the NASD and Nasdaq to assume that the creation of a Nasdaq File, separate and distinct from System market maker quotations, would not create an overwhelming perception of preferential treatment or at a minimum, a regulatory **“safe harbor”** for orders directed to a Nasdaq **“File”**. A Self Regulatory Organization (**“SRO”**) sponsored file such as the one contemplated in the Nasdaq proposal would attract a substantial number of orders away from System market makers. Since most broker-dealer and vendor routing systems are unable to distinguish immediately marketable limit orders from non-marketable limit orders, they are likely to choose one destination for all orders...markets as well as limits. **Therefore, the potential impact of this proposed independent SRO file as a competing destination for system limit orders represents a significant burden on competition and should be characterized as an inappropriate activity on the part of an SRO whose membership is chartered to engage in such activity.** An independent Nasdaq limit order file would be no less of an intrusion on its broker-dealer members than would an NASD and Nasdaq Board initiative to offer independent NASD sponsored capital raising and underwriting services for the benefit of all investors and market participants without the need for broker-dealer investment bankers. This **“Limit Order File”** proposal clearly presents a significant burden on competition for all other providers of limit order services. More importantly, it would create a disturbing precedent that could lead to future conflicts of interest between broker-dealers and their SROs.

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<sup>2</sup> NASD Business Conduct Rule 2110, IM-2110-2 **“...members acting as market makers that handle customer limit orders whether received from their own customers or from another member, are prohibited from trading at prices equal or superior to that of the limit order without executing the limit order...”**

## **The NASD should adopt the Securities Industry Association alternative proposal for a Nasdaq limit order facility**

The Securities Industry Association (SIA), in an effort to better understand the NASD's goals for its limit order facility, met with NASD officials to ascertain their requirements. There appeared to be four objectives: to provide a facility where limit orders can be represented in all market conditions, to allow NASD members and Sponsored Participants to place limit orders on an anonymous basis (similar to ECN's), to provide small broker-dealers that don't have a relationship with a wholesaler a place to send their order flow, and to provide a qualified display alternative for market makers who choose not to represent customer or proprietary limit orders in their quotes. In support of these goals, the SIA has put forward an alternative proposal that would accomplish all of the stated objectives for a Nasdaq limit order facility and still include voluntary market maker participation for representing non-directed system limit orders directly in market maker quotations. If in fact the NASD and Nasdaq Boards truly **intended to supplement not supplant the market maker**, they should support the SIA proposal which offers Nasdaq System market makers the opportunity to represent these non-directed limit orders directly in their quote, acting as agent/riskless principal in the same manner as specialists act on other U.S. Exchanges.

The SIA alternative to the Nasdaq proposal would still provide order entry participants with the ability to enter limit orders to buy and sell Nasdaq securities, which would then be routed to Nasdaq System market makers in those securities on a rotational basis. Market maker participation in this facility would be voluntary. Participating market makers must comply with the SEC's Order Handling Rules, Manning and all other Best Execution Rules, just as they do with orders delivered to them from their own customers. If desired, the orders could be entered anonymously. Upon receipt of these non-directed limit orders, delivered through the Nasdaq network, System market makers would have the opportunity to accept or reject these orders. If accepted they must either be executed or immediately represented in their market maker quotation. Upon execution, the fills would be routed back to the Order Entry Participant through the System. If the System market maker chose to reject the order, as is his right under the Order Handling Rules, the order would immediately be included in the Nasdaq limit order book where the order would reside in its appropriate price/time priority in relation to all other displayed System interest.

All of the contemplated components and functionality of an integrated Nasdaq limit order facility would still be available for System Order Entry Participants without the need to displace market makers. The SEC's Order Handling and Nasdaq Rules would guarantee the integrity of order handling and best execution by System market maker participants. All system orders would be assured of their appropriate price/time priority for processing and handling. Market orders and immediately marketable limit orders would interact with System quotations on a strict price/time priority as described in the filing.

Nasdaq would still be able to offer the contemplated anonymity features outlined in the filing. Order Entry Participants could rely on Nasdaq to provide anonymity and secure the identity of the party entering the order. Market makers need only be assured of a "locked-in trade". Any fees charged by Nasdaq in conjunction with the use of this facility by Order Entry Participants should be passed on to participating System market makers after having deducted Nasdaq's expenses.

The Limit Order Display rules are very clearly defined by both the SEC and Nasdaq. It is the responsibility of all market making firms to comply with those rules. It is also the right of a market maker to refuse to accept limit orders. In the event that there is no voluntary System market maker limit order participation in a particular issue, Nasdaq would then have in place a facility that handles the display and execution of the orders in that security without the interaction of a market maker. This would insure continuous availability of a limit order system for Order Entry Participants under all market conditions.

**Nasdaq's agreement with Optimark jeopardizes broker-dealer commitment to and participation in the National Market System (NMS)**

The Optimark system presents a unique, innovative, although problematic alternative to traditional order entry and participation in the price discovery and capital commitment process for the institutional investor. It enables sophisticated investors to define the terms and conditions of their order interest without the necessity of revealing their identities or their prices to the marketplace. It allows Optimark participants to "free-ride" off of other NMS participants who are contributing their orders to the marketplace for the benefit of price discovery and transparency for all market participants. Furthermore it provides this facility without the need for broker-dealer participation other than for clearance and settlement guarantees.

Optimark's agreement with Nasdaq to offer trade-through protection to all limit orders residing in the Nasdaq limit order file creates an unfair advantage for the Nasdaq "file" in that multiple price levels for limit order protection can be achieved for order entry participants. Market makers who wish to compete with the "file" would have to offer similar assurances but could not achieve the same protection for multiple price levels unless they were willing to pass through their entire limit order file to either the Nasdaq "file" or directly into Optimark. This additional cost or risk would create an unfair burden on competition for all those who wish to compete for retail as well as institutional order flow.

Even more troubling is the apparent endorsement by a SRO of a facility that is contrary to the mandate for transparency and price discovery embodied in the '75 Securities Acts. The Order Handling Rules require all market makers to promptly display or execute orders directed to them that would improve the national best bid or offer (NBBO). **The Optimark system is predicated on non-disclosure.** Although the SEC has sanctioned such activity in limited circumstances, it does not mean that Nasdaq should endorse this type of activity by incorporating this functionality in its System. It allows sophisticated institutional investors to "free-ride" and take advantage of the transparency and price discovery provided by market makers quotations and retail order flow.

Nasdaq's proposed integration of the Optimark functionality in its' System provides further evidence of the NASD's decision to supplant the market-maker and obviate the need for broker-dealers. Institutional investors will now have another facility in addition to the proposed Nasdaq limit order file which will provide the necessary access, market integration and trade reporting to validate their fiduciary responsibility without the need for broker-dealers. It is inappropriate for Nasdaq, whose charter is to serve its' members as well as investors, to provide systems and facilities that directly compete with its' sponsors whose dues and fees pay for the development, operation and maintenance of the Nasdaq system.

#### **Nasdaq must encourage and provide incentives for market maker commitment**

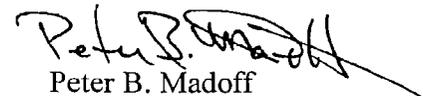
Nasdaq market makers have played a significant part and have been an integral component in the success of the Nasdaq dealer marketplace. Their commitment to regular and continuous market making has provided continuity for quotations and vital capital for trade executions. They have invested significant resources to build and develop proprietary systems and networks that have complemented and enhanced the Nasdaq marketplace. Furthermore, Nasdaq market maker quotations and trading activity generate significant revenues for the Nasdaq Stock Market which enable Nasdaq to continue to enhance its systems for the benefit of the entire marketplace.

The Nasdaq Stock Market, Inc. should build systems that encourage System market maker participation. It should offer its networks and facilities as an incentive and benefit for those market makers willing to participate and contribute to the increased transparency, accessibility and liquidity that these systems offer. The SIA proposal for a Nasdaq limit order facility, structured to include voluntary market maker participation, would give all System market makers an equal chance to represent non-directed limit orders in their market maker quotations. It would also encourage market makers to compete for future directed orders from new customers who have had a chance to experience the market maker's performance.

The NASD and Nasdaq Boards have endeavored to propose a new comprehensive System that ensures the viability and integrity of the Nasdaq marketplace. It has put forward significant changes and enhancements for comment that will have far reaching consequences for all market participants. Most of these changes are long overdue and will contribute greatly to the effectiveness of the Nasdaq marketplace. But they have coupled these changes with an unnecessary and contradictory exclusion of market makers from a Nasdaq limit order facility that need not displace market maker participation; in fact such a facility could only benefit from voluntary market maker participation and support. Nasdaq's inclusion of System market makers in a distributed limit order facility would be a strong endorsement of the dealer marketplace's ability to evolve and accommodate more "order-driven" features within the Nasdaq environment. It would validate the NASD's confidence in its market makers' ability to comply and enhance the SEC's Order Handling and Nasdaq Rules. This partnership would encourage broader participation by System market makers as well as Order Entry Participants and would speak to the fairness and integrity of the Nasdaq marketplace by ensuring timely transparency and quality of execution. There is simply no need to displace market makers that are willing and able to perform riskless principal/agency functions on behalf of the Nasdaq System's Order Entry Participants.

Sincerely,

  
Bernard L. Madoff

  
Peter B. Madoff

\*\*\*\*\*  
OFFICE OF THE CHAIRMAN  
\*\*\*\*\*

DATE ASSIGNED : 05/11/98 CONTROL #: 075904

DATE OF CORRES.: 05/04/98 MASTER #: 0000472016

DATE DUE :  / /

ASSIGNED TO: CS KATZ

ACTION REQUIRED: PROPER DISPOSITION

CORRESPONDENT: BERNARD L. MADOFF

ORGANIZATION: SIA

CONSTITUENT: \_\_\_\_\_

SUBJECT: COMMENT LTR RE NASD-98-17

SPECIAL INSTRUCTIONS: \_\_\_\_\_

COPIES TO: \_\_\_\_\_  
\_\_\_\_\_

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COMPLETE THIS SECTION AND RETURN TO EXECUTIVE CORRESPONDENCE  
ASSISTANT, OFFICE OF THE CHAIRMAN, ROOM 6010, STOP 6-1  
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DRAFTED BY: \_\_\_\_\_ PHONE: \_\_\_\_\_

DIVISION DIRECTOR APPROVAL: \_\_\_\_\_ DATE: 5/11

COMMENTS: Filed

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CHAIRMAN'S OFFICE REVIEW

LEGISLATIVE AFFAIRS: \_\_\_\_\_ DATE: \_\_\_\_\_

CHAIRMAN'S OFFICE: \_\_\_\_\_ DATE: \_\_\_\_\_

COMMENTS/CHANGES:

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OFFICE OF THE CHAIRMAN  
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DIVISION DIRECTOR APPROVAL: \_\_\_\_\_ DATE: \_\_\_\_\_

COMMENTS: \_\_\_\_\_

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LEGISLATIVE AFFAIRS: \_\_\_\_\_ DATE: \_\_\_\_\_

CHAIRMAN'S OFFICE: \_\_\_\_\_ DATE: \_\_\_\_\_

COMMENTS/CHANGES:



**Securities Industry Association**

1401 Eye Street, NW, Washington, DC 20005-2225, (202) 296-9410, Fax (202) 296-9775  
info@sia.com, http://www.sia.com

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OFFICE OF THE CHAIRMAN

May 4, 1998

Jonathan G. Katz  
Secretary  
Securities and Exchange Commission  
450 Fifth Street, NW  
Washington, DC 20549

Re: Securities Exchange Act Release No. 34-39718; File No. NASD-98-17

Dear Mr. Katz:

The Trading Committee ("Committee")<sup>1</sup> of the Securities Industry Association ("SIA")<sup>2</sup> appreciates the opportunity to provide comments to the Securities and Exchange Commission ("SEC" or "Commission") regarding the National Association of Securities Dealers, Inc.'s ("NASD") proposed Integrated Order Delivery and Execution System (the "System"). The proposed System will provide an automated execution facility that will consolidate the Nasdaq Stock Market's ("Nasdaq") two principal trading systems, *i.e.*, the Small Order Execution System ("SOES") and SelectNet, coupled with a Nasdaq-sponsored voluntary limit order book that will allow NASD members and sponsored participants to enter and display anonymous limit orders without the need for those limit orders to be represented in a market maker's<sup>3</sup> quotation.

<sup>1</sup>The Trading Committee was formed in May of 1996 to provide a focal point for addressing regulatory and legislative proposals dealing with trading issues. The Committee represents a diverse constituency—New York Stock Exchange ("NYSE") specialists, major wirehouses, regional firms, institutions, wholesalers, and market makers.

<sup>2</sup> The Securities Industry Association ("SIA") brings together the shared interests of nearly 800 securities firms, employing more than 380,000 individuals, to accomplish common goals. SIA members—including investment banks, broker-dealers, and mutual fund companies—are active in all markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of more than 50 million investors directly and tens of millions of investors indirectly through corporate, thrift, and pension plans, and accounts for \$270 billion of revenues in the U.S. economy. This and other recent SIA comment letters can be found on SIA's Internet home page, <http://www.sia.com>.

<sup>3</sup> Throughout this letter, the terms "market maker" and "dealer" are used interchangeably.

Jonathan G. Katz

May 4, 1998

Page 2

The Committee enthusiastically supports the automated delivery and execution features of the System and applauds the NASD for addressing the problems that member firms have experienced in managing multiple points of execution. While the Committee shares the NASD's goal of providing a fair market structure for all investors, we believe that the proposed limit order facility, as described in the filing, has anti-competitive elements that could operate to the detriment of public investors. We are confident, however, that the limit order facility could be designed in a way, as discussed below, that would meet investors' needs and guarantee investor protection while maximizing competition and enhancing liquidity in the Nasdaq market. We strongly urge the SEC and the NASD to consider this alternative.

The NASD's proposed System will enable all registered participants to send orders to access the best market maker quotation, qualified Electronic Communications Network ("ECN") order, or orders entered in the Nasdaq Limit Order Book. Registered NASD members, and certain customers that are sponsored by NASD members, will be able to deliver orders of varying size through the new System to electronically access the displayed quotations. The NASD states that the System is intended to respond to the demands of investors and NASD members for a marketplace that provides for fast and efficient access to the best prices in the market and effective integration of price discovery, execution, and trade reporting.

The Committee fully supports these goals and believes that recent changes in the Nasdaq market already have largely achieved these objectives. Since implementation of the Commission's order handling rules,<sup>4</sup> customer limit orders can compete with market maker quotations to drive the National Best Bid and Offer ("NBBO"). Subject to very limited exceptions, a dealer must execute an order or change his quotation to reflect a better priced customer limit order, thus assuring investors that the best prices are displayed to the entire market.<sup>5</sup> Additionally, under current NASD rules, a dealer is prohibited from trading ahead of a public limit order that he holds.<sup>6</sup> In fact, if a market maker holds an undisplayed limit order priced better than the quote, and he subsequently receives a market order on the opposite side of the market from the limit order, the market maker must pass along the price improvement of the limit order to the market

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<sup>4</sup> Securities Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290.

<sup>5</sup> A market maker also may comply with this requirement by delivering better priced orders to an ECN provided that the ECN disseminates these priced orders to the public quotation system and provides broker dealers equivalent access to these orders ("ECN Alternative").

<sup>6</sup> NASD Rule 2110, IM-2110-2.

Jonathan G. Katz

May 4, 1998

Page 3

order.<sup>7</sup> The opportunity for customer orders to match against customer orders, therefore, which Congress, the SEC, and the NASD support,<sup>8</sup> and which public investors demand,<sup>9</sup> already exists.<sup>10</sup> Moreover, market makers' and other intermediaries' bids and offers interact as well. Certainly, a single, automatic execution system, as the NASD proposes, with the ability to execute against ECN as well as market maker quotations will further ensure fast access to those prices.

As contemplated by the Commission, the order handling rules have enhanced competition resulting in narrower spreads and greater transparency of customer limit orders. The Committee believes, however, the NASD proposed limit order facility could greatly reduce, if not eliminate, the vibrant limit order competition that the order handling rules have generated. As discussed in more detail below, the limit order facility, as proposed, automatically gives the NASD--a membership-funded self-regulatory organization ("SRO")--an unfair advantage over its members who also provide limit order services. If market making becomes less profitable because of an unfair advantage enjoyed by the NASD, market makers will exit the business leading to less liquidity and wider spreads in many issues. Many low liquidity stocks and small issuers could be left without market maker sponsorship. While a few of the most active Nasdaq issues undoubtedly can survive, and even thrive, in an order-driven market, this is not the case for most Nasdaq issues. Ultimately, the primary function of equity markets--capital raising for public corporations--could be impeded, and, in times of market stress, there could be an insufficient number of market participants with affirmative obligations to trade in the Nasdaq market to sustain price continuity.

The Committee acknowledges that investors have enjoyed significant savings as a result of the order handling rules but cautions that there is a price to pay for that benefit. There are limits to liquidity. In view of the potential impact of the limit order facility as proposed, the Committee strongly urges the Commission and the NASD to consider the SIA alternative that has been advanced by the Trading Committee, which involves market maker participation in the limit order facility. Combined with a market-wide trade

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<sup>7</sup> NASD Notice To Members 97-57.

<sup>8</sup> See Pub. L. No. 94-29, 89 Stat. 97 (1975); U.S. Securities and Exchange Commission, Division of Market Regulation, Market 2000 An Examination of Current Equity Market Developments (January 1994), at Study I; and SEC Release No. 34-39718 (March 4, 1998), 63 FR 12124 (SR-NASD-98-17).

<sup>9</sup> See Public File, SR-NASD-98-17.

<sup>10</sup> When a dealer executes a customer limit order reflected in his quotation, he acts as an agent or riskless principal, just like an exchange specialist, and may charge a fee but does not capture the spread.

Jonathan G. Katz

May 4, 1998

Page 4

through rule, as discussed below, the Committee believes this approach promotes investor protection, encourages capital formation, and facilitates fair competition within the existing competing dealer market structure.

## Background

Since 1996 the Trading Committee has helped shape, review, implement, and monitor the many proposed market structure changes. In commenting on the proposed order handling rules,<sup>11</sup> the NASD's proposed NAqcess System,<sup>12</sup> and various other changes,<sup>13</sup> the Committee has consistently supported change that promotes transparency, competition, and investor protection while resisting any efforts to dilute the competitive essence of the Nasdaq dealer market. With the adoption of the SEC order handling rules in 1997, the Nasdaq market has taken on many characteristics of an auction market. Although auction market principles may be appropriate for deep and liquid stocks, competing dealers are critical in those issues where no natural liquidity exists.

The competing dealer structure of the Nasdaq Stock Market provides substantial benefits to issuers and investors. Nasdaq electronically links dealers and ECNs around the country in over 5,000 issues by automating the display of dealer and ECN quotations. Originally designed as a market of competing dealers in thinly traded over the counter securities, it has been an extremely successful model, providing strong support for small issuers at an important stage in their growth. Market makers are a key component of Nasdaq's strength, risking capital and providing liquidity in times of market stress. A testament to the success of the Nasdaq market is that it now trades over 600 million shares per day and includes such widely-held, actively-traded issues as Intel, Microsoft, and Cisco Systems. Without the support and commitment of market makers, the Nasdaq market could never have achieved such growth. Moreover, without the support and commitment of market makers, companies such as these may never have achieved such growth.

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<sup>11</sup> See Letter to Jonathan G. Katz, Secretary, SEC, from A.B. Krongard, Chairman, SIA Board of Directors, Bernard L. Madoff and Robert Murphy, Co-Chairmen, Order Execution Committee, dated February 26, 1996.

<sup>12</sup> See Letter to Jonathan G. Katz, Secretary, SEC, from A.B. Krongard, Chairman, SIA Board of Directors, and Bernard L. Madoff, Chairman, SIA Trading Committee, dated August 1, 1996.

<sup>13</sup> See, e.g., Letter to Jonathan G. Katz, Secretary, SEC, from Bernard L. Madoff, Chairman, SIA Trading Committee, dated December 26, 1996 (regarding NASD rule changes necessary to implement the SEC order handling rules), and Letter to Richard R. Lindsey, Director, Division of Market Regulation, SEC, from Bernard L. Madoff, Chairman, SIA Trading Committee, dated January 22, 1997 (regarding actual size quotations).

Technological developments over the last several years have accelerated this growth and led to better services, greater efficiency, and more competition among market participants. The NASD and Nasdaq market makers have been at the forefront of the technology revolution, capitalizing on new technologies to constantly enhance the quality of the market and increase the services that they provide. Market makers also have invested significant resources in the development of proprietary automated systems for executing customer orders. These systems add liquidity to the market, increase efficiencies, and offer immediacy of execution. In addition, the demands of different types of investors have given rise to innovative trading systems that directly compete with the exchange and Nasdaq markets. Consequently, there is an ever-increasing array of markets and dealers through which to trade securities.

The Committee supports the efforts of the NASD to remain viable in the face of a changing market structure but believes the appropriate response should be one that provides a level playing field and encourages rather than reduces competition among the various providers of limit order services. The NASD System should include, not exclude, those market participants that have made Nasdaq one of the most innovative and successful markets in the world. Instead of competing with its members, whose dues and fees have funded the technological expansion of the Nasdaq market, the NASD should partner with its members to design an integrated system that increases competition, enhances market liquidity, and reduces transaction costs.

In designing the market for the next Millenium, we must be careful to balance the diverse needs of **all** market participants—issuers, retail and institutional investors, and market professionals, including market makers who provide liquidity. The Committee believes, however, that the limit order model the NASD has constructed will create a technological monopoly that would stifle competition in the Nasdaq market.

### **The Proposed Limit Order Facility Will Stifle Competition**

As proposed, the NASD System will permit directed and non-directed orders<sup>14</sup> to access market maker, ECN, and UTP exchange specialist quotations and orders in the limit order facility. Directed orders will not interact with orders in the limit order facility or with other market maker quotations displayed in the Nasdaq montage. Directed orders

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<sup>14</sup> Directed orders are orders that an order entry firm chooses to send to a specific market maker, ECN, or UTP exchange specialist for delivery and execution. Non-directed orders are orders that are not sent to a particular market maker or ECN, *i.e.*, when the member entering the System doesn't specify a particular market maker, ECN, or UTP exchange, the order will be sent to the next available executing participant.

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will be processed in time sequence with non-directed orders. Non-directed orders, on the other hand, will interact with the best quotes in the Nasdaq montage in price/time sequence. Non-directed orders that match against an order in the limit order facility will be executed immediately. Non-directed orders delivered to a market maker or an ECN, depending on the size of the order, will be executed immediately (up to the displayed quote size) if the order is for 1,000 shares or less, or executed after a delay of 17 seconds for orders greater than 1,000 shares but less than 5,000 shares, or 32 seconds for orders of 5,000 shares or more. This letter assumes, and the positions stated herein are contingent upon, SEC approval of the NASD proposal to allow market makers to quote their actual size rather than an artificial minimum quotation size for all Nasdaq National Market ("NNM") securities. The SIA Trading Committee strongly supports this proposal.

Although certain features of the proposed System will serve to enhance competition in the Nasdaq market, the Committee believes the proposed limit order facility, as designed by the NASD, will stifle competition. The ability for all market participants to access a single automatic execution system on the same terms will level the playing field and eliminate advantages previously enjoyed by professional day traders. The NASD proposed limit order facility, on the other hand, will create a de facto monopoly for the NASD. Although it is characterized as being a voluntary option for the display of customer limit orders, we believe the effect of the proposed rules will be to drive all orders toward this one mechanism where trades will be executed. The Nasdaq limit order facility will discourage the development and inhibit the continued use of competing limit order systems, or may cause other market participants to abandon them altogether. Without competing technologies, the entire market will become dependent on the capacity and integrity of a single system.

The NASD proposed limit order facility will have several distinct competitive advantages over other market participants. The Nasdaq limit order facility will accept, display, and execute limit orders at any price level. In contrast, market makers and ECNs are able to display only one price level, *i.e.*, one bid and one offer, and have to update their quotation after execution to get the next level of interest displayed and available for execution. The ability of the Nasdaq limit order facility to hold and display several levels of interest will almost always result in the limit order facility having time priority, which could result in poorer executions for customer limit orders held outside the Nasdaq limit order facility.

Also, the ability to expose several levels of bids and offers to the market enables the limit order facility to participate in large or "rapid fire" market orders. For example, suppose there are two market makers in a security, market maker #1 and #2, both bidding for 1,000 shares at 10. Each of the market makers also holds customer buy orders for 1,000 shares at 9 7/8. The limit order facility holds a limit order to buy 1,000 shares at 9

¾. Three market orders to sell 1,000 shares are entered into the System. Market maker #1 is executed against and is decremented to 0. Market maker #2 is executed against and is decremented to 0. The remaining 1,000 share market order will execute versus the 9 ¼ buy limit order in the limit order facility before the market makers can update their quotations to display their 9 7/8 bids.

Although members will not be required to protect orders in their own limit order files beyond their best execution obligation, as a practical matter, in order to compete for limit orders, market makers will have to provide customers with price protection at a specific price equivalent to that which the limit order may have received in the Nasdaq limit order facility. Market makers will be required, for competitive reasons, to execute limit orders in response to a depletion of interest in the Nasdaq limit order facility, which may not reflect actual supply and demand in the marketplace. These orders will be executed out of competitive necessity even though the market maker has not effected any purchases or sales at that price. Because of this, market makers will have less incentive for handling limit orders outside of the Nasdaq limit order facility. Indeed, because of the advantage the System has of always being first in time, best execution obligations may actually **require** market makers to direct their customer limit orders to the Nasdaq limit order facility. Thus, an SRO monopoly of limit-order services is assured.

In addition, subsequent to filing this proposal with the Commission, the NASD announced an agreement in principle between the Nasdaq Stock Market and OptiMark Technologies, Inc. that would directly link the proposed Nasdaq limit order facility with the OptiMark technology.<sup>15</sup> The OptiMark technology will allow investors, instead of entering orders at only one price and size, to indicate, across a range of prices and sizes, their willingness to trade. Because OptiMark executions will provide trade-through protection to all limit orders residing in the Nasdaq limit order facility and other displayed interest, multiple price levels for limit order protection can be achieved for orders entered into the Nasdaq limit order facility. However, market makers and ECNs are only guaranteed protection through OptiMark at their displayed price level. Market makers who want to compete with the Nasdaq limit order facility would have to offer equivalent assurances but could not achieve the same protection for multiple price levels without passing their limit order file to the Nasdaq facility.

Finally, most broker-dealer and vendor routing systems are unable to distinguish immediately marketable limit orders from non-marketable limit orders. Consequently, they are likely to choose one destination for all orders. If one destination also happens to be the market regulator, there may be a strong incentive for choosing that facility in the

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<sup>15</sup> See NASD Press Release, January 13, 1998.

expectation that it will provide a regulatory safe harbor for compliance with best execution and other regulatory obligations.

The Committee believes it is inappropriate for an SRO to operate a System that will compete with its members for order flow, and that is not commercially viable without the regulatory power and position of the SRO. Membership dues and fees have funded the development of the Nasdaq market and, over the years, members have spent millions of dollars building and upgrading their own proprietary systems that have kept the Nasdaq Stock Market on the cutting edge. It is disturbing that the NASD proposes to build, operate, and maintain a System that, in its current design, will undermine the competitiveness of those proprietary systems. In addition, in light of the NASD's equity interest in the OptiMark technology, there is a troubling incentive for the NASD to use its position as regulator to gain an advantage over its member-competitors.

The Committee firmly believes that competition generates best prices and improves the efficiency and quality of the market. A comprehensive system that will attract a significant amount of order flow operated by the NASD is inconsistent with the intent of Congress to allow innovation and competitive forces to shape the National Market System. Although the Nasdaq limit order facility may appear to offer certain advantages today, it will almost certainly destroy any incentive for future innovations in the handling of limit orders. The SEC should ensure that the Nasdaq limit order facility is only one of many sources of quotations in the Nasdaq market.<sup>16</sup>

#### **SIA Trading Committee Alternative**

As noted above, the Trading Committee proposes an alternative that satisfies the NASD's objectives, fulfills the needs of investors, and, at the same time, features market maker participation in a positive way. Indeed, we believe the Trading Committee alternative is superior to the proposed System in that it establishes a limit order facility that will encourage broader participation by market makers adding even more depth and liquidity to the Nasdaq market.

The SIA alternative would provide NASD members and sponsored participants the ability to enter directed and non-directed limit orders to buy and sell Nasdaq securities. Non-directed orders would be routed to Nasdaq System market makers in those securities on a rotational basis. Participating market makers would be required to comply with all regulatory obligations including order handling, Manning, and all best

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<sup>16</sup> In fact, Congress has directed the SEC to assume a special oversight and regulatory role in situations where natural competitive forces cannot be relied upon, such as where a self-regulatory organization enjoys an effective monopoly. S. Rep. No. 75, 94<sup>th</sup> Cong., 1<sup>st</sup> Sess. (1975), at 12.

execution interpretations. Orders could be entered anonymously, just as in the NASD proposed System. Upon receipt of a non-directed limit order delivered through the Nasdaq System, a market maker active in the rotation would have to accept the order and would have to execute it or represent it in his quotation, with the market maker acting as riskless principal in the same manner as an exchange specialist. Upon execution, the fill would be routed back to the entering participant through the Nasdaq System. If there were no market makers active in the rotation, the order would immediately be included in the Nasdaq limit order facility where the order would reside in its appropriate price/time priority in relation to all other displayed interest.

Under the SIA alternative, all of the functionality of an integrated Nasdaq limit order facility would be available. Order entry participants could rely on Nasdaq to provide anonymity and secure the identity of the party entering the order. Market orders and immediately marketable limit orders would interact with System quotations on a strict price/time priority as described in the filing. The SIA alternative, however, would provide an immediate automatic execution of these orders. Marketable orders of any size would be immediately executed against the quoted size of any market maker or combination of market makers that would satisfy the order. Orders would also immediately execute against the market maker's supplemental or reserve size.

In the NASD proposal, only orders of 1000 shares or less receive automatic executions against market makers. Orders over 1,000 shares can be delayed for as much as 17 seconds and orders over 5,000 shares can be delayed for as much as 32 seconds. The SIA Trading Committee believes the delays are unnecessary and create uncertainty in the market. Thus, investors seeking rapid executions at the best available prices will be advantaged by the system we propose.

If the Commission nonetheless decides to approve the System as proposed notwithstanding our comments, we believe that a trade through rule, as discussed below, must be mandated.

### **Fairness Dictates a Market-Wide Trade Through Rule**

The Committee strongly believes that a market-wide trade through rule should be imposed. Fundamental principles of fairness dictate that no market participant should be allowed to trade through any displayed interest in the Nasdaq market. All orders, whether they are sent to the proposed Nasdaq limit order facility or displayed by market makers in their quotations, should receive equal treatment.

As proposed by the NASD, the System will allow inferior priced trades to be executed in the Nasdaq System without satisfying all better-priced interest displayed in

Jonathan G. Katz  
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Page 10

market maker quotations. It is incumbent upon the NASD to insure the integrity of quotations irrespective of whether they reside in the limit order facility or with a market maker. In fact, the NASD proposes to provide trade-through protection through OptiMark for all limit orders residing in the Nasdaq limit order facility and other displayed interest.

Undisplayed orders or supplemental size should not be protected. Market makers, therefore, would have an incentive to display their true trading interest, which will increase transparency in the market. A market-wide trade through rule also would provide incentives for market makers to continue to provide liquidity by enabling market makers to continue to operate their own proprietary execution systems on a more equal footing.

### **Conclusion**

The Trading Committee fully supports market structure changes that promote competition, transparency, accessibility, and fairness for all investors. As proposed, however, the Committee believes the NASD proposed limit order facility will reduce competition, discourage market maker participation in the Nasdaq market, and jeopardize the capital market makers bring to bear in support of the trading of new and smaller capitalized companies in which there may not be sufficient natural liquidity. Having a self-regulator operate a trading system that competes with its regulated members creates irreconcilable conflicts of interest that will ultimately hurt investors.

During the past year, many major changes were introduced in the Nasdaq market including, among other things, new order handling rules, finer increments of trading, and new interpretations with respect to best execution obligations. The benefits to the market are apparent—increased transparency and better prices for retail customers. Notably, the changes were implemented at a time when the markets are robust and volume is high. Nevertheless, anecdotal evidence suggests that market makers are widely reducing the number of stocks in which they make a market. Although net market making does not appear to have declined, the support provided for various issues has not been quantified. The true economic impact on market making has been obscured by the continuing bull market, record volume, and general prosperity enjoyed by Wall Street firms. It is doubtful that there would be the same level of commitment if any one of these factors was removed.

We, therefore, urge the Commission to proceed cautiously with initiatives that could provide disincentives for market makers to provide liquidity and to sponsor new issues. The Trading Committee has proposed an alternative that brings all market participants and investors together in an integrated order delivery and execution system

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Page 11

where all orders are processed and distributed in a fair and orderly fashion, and at the same time preserves a competitive dealer market structure. The Committee respectfully requests that the Commission and the NASD consider this alternative.

The SIA thanks the Commission for the opportunity to comment on this major rule proposal. If the Committee can provide additional information, or if you would like to discuss our views further, please contact the undersigned, or Judith Poppalardo, SIA Associate General Counsel, at (202) 296-9410.

Sincerely,



Bernard L. Madoff  
Chairman  
Trading Committee

cc: The Honorable Arthur Levitt, Chairman, SEC  
The Honorable Norman S. Johnson, Commissioner  
The Honorable Isaac Hunt, Jr., Commissioner  
The Honorable Laura S. Unger, Commissioner  
The Honorable Paul Carey, Commissioner  
Dr. Richard R. Lindsey, Director, Division of Market Regulation  
Frank G. Zarb, Chairman, National Association of Securities Dealers, Inc.  
Richard G. Ketchum, President, National Association of Securities Dealers, Inc.  
Alfred R. Berkeley, III, President, The Nasdaq Stock Market, Inc.

**OFFICE OF THE CHAIRMAN**  
**Correspondence Tracking Sheet**

*Nancy  
Code C*

Date Assigned: 05/27/1999 *rel 5/28*

Control #: ES80052

Date Of Corres: 05/26/1999

Master #: 701904

Due Date:

Contact Type: EXPRESS

Assigned To: Annette Nazareth MR

Action Required: Proper Disposition

Correspondent: PETER B MADOFF

Title:

Affiliation: BERNARD L. MADOFF INVESTMENT SECURITIES

Constituent:

Subject: NASDAQ SYSTEM ENHANCEMENT: SINGLE PRICE OPENING

Special Instructions:

Copies To: Levitt Scardino Corso

**COMPLETE THIS SECTION AND RETURN TO THE EXECUTIVE CORRESPONDENCE UNIT,  
OFFICE OF THE CHAIRMAN, ROOM 6106, STOP 6-1**

Drafted By: *Richard Strasser*

Phone: *(212) 945-0073*

Division Approval:

Date: *6-2-99*

Comments: *NRN, 6/2/99*

**CHAIRMAN'S OFFICE REVIEW**

Legislative Affairs:

Date:

Returned:

Comments:

Chairman's Office:

Date:

Returned:

Comments:

*Code: C*

*Due: 6/18*

*To: Sarow*

**BERNARD L. MADOFF**  
**Investment Securities**

885 Third Avenue New York, NY 10022-4834

212 230-2424

800 334-1343

Telex 235130

Fax 212 486-8178

Peter B. Madoff

May 26, 1999

Chairman Arthur Levitt  
U.S. Securities & Exchange Commission  
450 5<sup>th</sup> Street, N.W.  
Washington, D.C. 20549

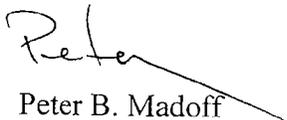
Dear Arthur:

Bernie and I would like to inform you of a new enhancement to our order execution and price improvement services for Nasdaq securities: The Single Price Opening Cross.

We believe our customers will derive significant benefits from this initiative.

We hope you are pleased.

With warm regards,

  
Peter B. Madoff

OFFICE OF THE CHAIRMAN

99 MAY 27 PM 4:50

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ES 80052

Affiliated with:  
Madoff Securities International Ltd.  
12 Berkeley Street, Mayfair, London W1X 5AD. Tel 0171-493 6222

MADOFF\_EXHIBITS-05458



**BERNARD L. MADOFF**  
**Investment Securities**

885 Third Avenue New York, NY 10022-4834

212 230-2424

800 334-1343

Telex 235130

Fax 212 486-8178

May 25, 1999

**Re: Nasdaq System Enhancement: Single Price Opening**

Dear Client:

Bernard L. Madoff Investment Securities is pleased to announce a significant enhancement to its order execution and price improvement services for Nasdaq securities: **The Single Price Opening Cross.**

Beginning June 28, 1999 Madoff will execute all of your customers' pre-opening market and marketable limit orders in Nasdaq stocks at a single price, using a crossing algorithm. This single price algorithm will operate as follows: Beginning at 9:30:00 a.m., our system will look for the first quote available via Nasdaq's Level 1 service that is neither locked nor crossed. We will then execute all market and marketable limit orders received from Madoff's customers prior to that point at a single "cross" price. Whenever the buy and sell interest for all **customer** orders within Madoff's own system is equal, that "cross" price will be the mid-point of the quote. If there is an imbalance between buyers and sellers, the bid or the ask will be used for the entire opening based on the side of that imbalance.

**Example 1.** If we receive 100,000 shares of market and marketable limit orders to sell DELL and 100,000 shares of market and marketable limit orders to buy DELL, and the Nasdaq Level 1 quote in DELL at 9:30:00 is 39 x 39 1/16 we will cross all of those pre-opening orders at 39 1/32.

**Example 2.** If we receive 100,000 shares of market and marketable limit orders to sell DELL and 50,000 shares of market and marketable limit orders to buy DELL, and the Nasdaq Level 1 quote in DELL at 9:30:00 is 39 x 39 1/16 we will cross all of these pre-opening orders at 39, since the net imbalance is on the sell side of the market.

**Example 3.** If we receive 50,000 shares of market and marketable limit orders to sell DELL and 100,000 shares of market and marketable limit orders to buy DELL, and the Nasdaq Level 1 quote in DELL at 9:30:00 is 39 x 39 1/16 we will cross all of these pre-opening orders at 39 1/16, since the net imbalance is on the buy side of the market.

**Example 4.** If we receive 100,000 shares of market and marketable limit orders to sell DELL and 100,000 shares of market and marketable limit orders to buy DELL, and the Nasdaq Level 1 quote in DELL at 9:30:00 is 39 x 39 (locked), we will wait until the market unlocks. When it does, we will execute all of the orders at the mid-point of the first non-locked/non-crossed quote.

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Madoff Securities International Ltd.  
12 Berkeley Street, Mayfair, London W1X 5AD.0171-493 6222

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We believe that this change in our handling of pre-opening orders will significantly benefit your customers and dramatically increase the amount of price improvement their pre-opening orders receive. If you have any questions about the functionality of this new system, please don't hesitate to call us at (212) 230-2424. As always, we appreciate the opportunity to compete for your business.

Sincerely,

A handwritten signature in black ink, appearing to read "Bernard L. Madoff".

Bernard L. Madoff

A handwritten signature in black ink, appearing to read "Peter B. Madoff".

Peter B. Madoff

**BERNARD L. MADOFF**  
**Investment Securities**

885 Third Avenue New York, NY 10022-4834

212 230-2424  
800 334-1343  
Telex 235130  
Fax 212 486-8178

Peter B. Madoff

May 26, 1999

Chairman Arthur Levitt  
U.S. Securities & Exchange Commission  
450 5<sup>th</sup> Street, N.W.  
Washington, D.C. 20549

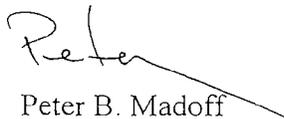
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We hope you are pleased.

With warm regards,

  
Peter B. Madoff

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885 Third Avenue New York, NY 10022-4834

212 230-2424  
800 334-1343  
Telex 235130  
Fax 212 486-8178

May 25, 1999

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Madoff Securities International Ltd.

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We believe that this change in our handling of pre-opening orders will significantly benefit your customers and dramatically increase the amount of price improvement their pre-opening orders receive. If you have any questions about the functionality of this new system, please don't hesitate to call us at (212) 230-2424. As always, we appreciate the opportunity to compete for your business.

Sincerely,

Handwritten signature of Bernard L. Madoff.

Bernard L. Madoff

Handwritten signature of Peter B. Madoff.

Peter B. Madoff

OFFICE OF THE CHAIRMAN  
**Correspondence Tracking Sheet**

Date Assigned: 08/23/2000

Control #: ES85742

Date Of Corres: 08/23/2000

Master #: 707594

Due Date:

Contact Type: FAX

Assigned To: Correspondence Files ESF

Action Required: For Your Information

Correspondent: BERNIE/PETER MADOFF

Title:

Affiliation:

Constituent:

Subject: PROCEDURES FOR HANDLING OF ORDERS IN UPCOMING DECIMAL ENVIRONMENT

Special Instructions:

Copies To: Levitt      Scardino      Lombard      Nazareth

COMPLETE THIS SECTION AND RETURN TO THE EXECUTIVE CORRESPONDENCE UNIT,  
OFFICE OF THE CHAIRMAN, ROOM 6106, STOP 6-1

Drafted By:

Phone: ( ) - -

Division Approval:

Date:

Comments:

*8/23*

**CHAIRMAN'S OFFICE REVIEW**

Legislative Affairs:

Date:

Returned:

Comments:

Chairman's Office:

Date:

Returned:

Comments:



**BERNARD L. MADOFF**  
**Investment Securities**

885 Third Avenue New York, NY 10022-4834

212 230-2424  
800 334-1343  
Telex 235130  
Fax 212 486-8178

August 23, 2000

Honorable Arthur J. Levitt, Jr.  
U.S. Securities and Exchange Commission  
Washington, DC 20549

Fax: 202-942-9646  
Pages to follow: 4

Dear Arthur,

Thought you might be interested in our procedures for the handling of orders in the upcoming decimal environment.

We hope you will be pleased with our new initiative and welcome any comments you might have.

Enjoy the remaining days of summer.

Regards,

Bernie and Peter Madoff

RECEIVED  
30 AUG 23 PM 4:21  
ES 85742  
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Affiliated with:  
Madoff Securities International Limited  
12 Berkeley Street, Mayfair, London W1X 5AD. Tel 0171-493 6222

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**BERNARD L. MADOFF**  
**Investment Securities**  
885 Third Avenue New York, NY 10022-4834

212 230-2424  
800 334-1343  
Telex 235130  
Fax 212 486-8178

August 23, 2000

**Client Update: Decimal-Pricing Pilot for NYSE Listed Securities**

Dear Client,

On August 28, 2000 the NYSE is initiating the trading of 7 securities in decimal prices on a pilot basis. September 25, 2000 will bring 52 additional symbols into the decimal-pricing pilot, including such high volume issues as America Online Inc. (AOL), Compaq Computer Corp. (CPQ), Daimler Chrysler AG (DCX), and Time Warner Inc. (TWX).

In our ongoing effort to provide you with a consistently superior level of service, we will be adapting the way our automated system handles your clients' orders in the stocks that are participating in the NYSE decimal-pricing pilot program. These changes will impact **only those securities participating in the pilot**. Orders in all other stocks will be handled the same way they have always been handled, as outlined in our "Guide to Best Execution" on our website at [www.madoff.com](http://www.madoff.com).

As you know, the hallmarks of our system are price improvement, speed, and enhanced liquidity delivered with a level of customer service that sets us apart from our competitors. You can rest assured that in the new decimal-pricing environment none of these things will change. However, a decimal-priced world will require a different approach to how we achieve these goals. It is for this reason that we have been working in partnership with 4 of the world's leading brokerage firms to develop the Primex Auction System. This system has been adopted by Nasdaq as one of the tools its members can use in their efforts to achieve best execution for their customers' orders. When the Primex System comes online in the 2nd quarter of 2001, we will incorporate it into our own automated trading system in such a way that affords your clients' orders all of its benefits in a completely seamless fashion.

Until then, we have developed a market based, algorithmic approach to defining price improvement and enhanced liquidity for those stocks that trade in decimals. Discussions with many of our clients have brought to light several key concerns with the new decimal-pricing environment: The difficulty of defining "meaningful" price improvement when stocks trade in pennies, the possibility of significantly reduced liquidity at the quoted national best bid/offer (NBBO), and the prospect of an increased number of "split tickets" or multiple-piece fills even on their smaller sized orders.

Affiliated with:  
Madoff Securities International Limited  
12 Berkeley Street, Mayfair, London W1X 5AD. Tel 0171-493 6222

MADOFF\_EXHIBITS-05466



We have attempted to address these concerns by designing our system to function as follows:

- **Price Improvement:** We will price improve all eligible market and marketable limit orders by 20% of the NBBO spread.

Eligible orders will include immediately executable market and marketable limit orders from 100-3,000 shares. The amount of improvement will be based on the NBBO spread at the time we receive your order and will be rounded to the nearest penny. The improvement will be no less than a penny per share. Orders larger than 3 times the size of the quote at the NBBO will not be eligible for automatic price improvement.

- **Enhanced Liquidity and Speed:** We will automatically execute at least 3 times the size quoted at the NBBO for orders up to 3,000 shares.

Orders up to 1,099 shares will be automatically executed in their entirety immediately upon receipt regardless of the size at the NBBO. For the vast majority of our customers, this means that 90% of your orders will be executed in a single piece. Orders 1,100 to 3,000 shares will receive an immediate execution for at least 1,000 shares or 3 times the size quoted at the NBBO, whichever is greater.

- **Order-Flow Rebates:** We will continue to offer an order-flow rebate of 10% of the NBBO spread. This policy will be expanded to include orders that receive price improvement.

Eligible orders will include immediately executable market and marketable limit orders that do not exceed 3,000 shares or 3 times the size quoted at the NBBO. Odd-lots will receive a rebate. The maximum rebate per share will be a penny and a half.

We are attaching a list of sample execution scenarios to help further explain how these policies will work.

The structure of the U.S. equity markets is changing rapidly. In the coming months, as we gain more experience with the impact of decimal-pricing on our markets we will continue to make whatever changes are necessary to the ways in which we do business to insure our competitiveness. Please don't hesitate to call us at (212) 230-2424 if you have any questions about these changes, or to give us your input in general. Thank you.

Sincerely,

Bernard L. Madoff

Peter B. Madoff



## **Sample Execution Scenarios**

### **Example 1: Federal Express Corp. (FDX)**

1. NBBO for FDX is 40 x 40.05 bid size: 10,000 shares ask size: 3,000 shares
2. Client sends an order to buy 2,000 FDX @ MKT
3. Order is executed immediately at 40.04
4. The client got price improvement of \$20 (20% of the .05 spread times 2,000 shares)
5. The firm that sent the order would be entitled to a rebate of \$10 (10% of the .05 spread times 2,000 shares)

### **Example 2: Gateway Computer Corp. (GTW)**

1. NBBO for GTW is 60 x 60.02 bid size: 5,000 shares ask size: 1,000 shares
2. Client sends an order to buy 3000 GTW @ MKT
3. Order is executed immediately at 60.01
4. The client got price improvement of \$30 (20% of the .02 spread would only have been .004, but we guarantee a minimum improvement of a penny so the rebate is .01 times 3,000 shares).
5. The firm that sent the order would be entitled to a rebate of \$6 (10% of the .02 spread times 3,000 shares)

### **Example 3: Forest City Enterprises Class A (FCE.A)**

1. NBBO for FCE.A is 39.40 x 39.69 bid size: 800 shares ask size: 400 shares
2. Client sends an order to buy 500 FCE.A @ 39.75
3. Order is executed immediately at 39.63
4. The client got price improvement of \$30 (20% of the .29 spread rounded to the nearest penny times 500 shares). Please note that we measure price improvement by comparing the execution price relative to the NBBO, not the order's limit price.
5. The firm that sent the order would be entitled to a rebate of \$14.50 (10% of the .29 spread times 500 shares)



**Example 4: Anadarko Petroleum Corp. (APC)**

1. NBBO for APC is 59.80 x 59.84 bid size: 1,000 shares ask size: 100 shares
2. Client sends an order to buy 1,000 APC @ MKT
3. Order is executed immediately at 59.84
4. This order is not eligible for price improvement, since it exceeds 3 times the quoted NBBO "ask" size.
5. The firm that sent the order would not be entitled to a rebate, since Madoff provided enhanced liquidity of more than 300%.

**Example 5: Forest City Enterprises Class B (FCE.B)**

1. NBBO for FCE.B is 38.03 x 38.11 bid size 2,000 shares ask size: 800 shares
2. Client sends an order to buy 2,000 shares @ MKT
3. Order is executed immediately at 38.09
4. The client got price improvement of \$40 (20% of the .08 spread rounded to the nearest penny times 2,000 shares).
5. The firm that sent the order would be entitled to a rebate of \$16 (10% of the .08 spread times 2,000 shares).

**Example 6: Hughes Supply Inc. (HUG)**

1. NBBO for HUG is 20 x 20.01 bid size: 2,000 shares ask size: 500 shares
2. Client sends an order to buy 2,500 HUG @ MKT
3. We will automatically execute 1,500 shares immediately at 20.01, which is 3 times the displayed liquidity in the NBBO.
4. The balance of 1,000 shares will be shipped via ITS to the market participants who are offering stock at 20.01 and executed on a share for share basis at the prices we receive, with Madoff acting as riskless principal. If there is insufficient liquidity at 20.01 to satisfy the balance of the order, we will ship to the market participants offering stock at the next quoted price increment. We will not execute your order outside the NBBO.
5. This order is not eligible for price improvement, since the NBBO spread was only .01
6. The firm that sent the order would not be entitled to a rebate, since the size of the order exceeded 3 times the size quoted at the NBBO.



**BERNARD L. MADOFF**  
**Investment Securities**

885 Third Avenue New York, NY 10022-4834

212 230-2424  
800 334-1343  
Telex 235130  
Fax 212 486-8178

August 23, 2000

Honorable Arthur J. Levitt, Jr.  
U.S. Securities and Exchange Commission  
Washington, DC 20549

Fax: 202-942-9646  
Pages to follow: 4

Dear Arthur,

Thought you might be interested in our procedures for the handling of orders in the upcoming decimal environment.

We hope you will be pleased with our new initiative and welcome any comments you might have.

Enjoy the remaining days of summer.

Regards,

Bernie and Peter Madoff

OFFICE OF THE CHAIRMAN

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00 AUG 23 PM 4:21

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**BERNARD L. MADOFF**  
**Investment Securities**  
885 Third Avenue New York, NY 10022-4834

212 230-2424  
800 334-1343  
Telex 235180  
Fax 212 486-8178

August 23, 2000

**Client Update: Decimal-Pricing Pilot for NYSE Listed Securities**

Dear Client,

On August 28, 2000 the NYSE is initiating the trading of 7 securities in decimal prices on a pilot basis. September 25, 2000 will bring 52 additional symbols into the decimal-pricing pilot, including such high volume issues as America Online Inc. (AOL), Compaq Computer Corp. (CPQ), Daimler Chrysler AG (DCX), and Time Warner Inc. (TWX).

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12 Berkeley Street, Mayfair, London W1X 5AD. Tel 0171-498 6222

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We have attempted to address these concerns by designing our system to function as follows:

- **Price Improvement:** We will price improve all eligible market and marketable limit orders by 20% of the NBBO spread.

Eligible orders will include immediately executable market and marketable limit orders from 100-3,000 shares. The amount of improvement will be based on the NBBO spread at the time we receive your order and will be rounded to the nearest penny. The improvement will be no less than a penny per share. Orders larger than 3 times the size of the quote at the NBBO will not be eligible for automatic price improvement.

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Sincerely,

Bernard L. Madoff

Peter B. Madoff



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OFFICE OF THE CHAIRMAN  
**Correspondence Tracking Sheet**

Date Assigned: 11/07/2002

Control #: ES99347

Date Of Corres: 11/01/2002

Master #: 721200

Due Date:

Contact Type: US MAIL

Assigned To: Correspondence Files ESF

Action Required: For Your Information

Correspondent: BERNARD L. MADOFF

Title:

Affiliation:

Constituent:

Subject: THANK YOU RE SEC ROUNDTABLE ON MARKET STRUCTURE

Special Instructions:

Copies To: Ritt Radke Panasiti Nazareth

COMPLETE THIS SECTION AND RETURN TO THE EXECUTIVE CORRESPONDENCE UNIT  
OFFICE OF THE CHAIRMAN, ROOM 6106, STOP 6-1

Drafted By:

Phone: ( )

Division Approval:

Date: 11-7-02

Comments:

*WAD* *EM*  
CHAIRMAN'S OFFICE REVIEW

Legislative Affairs:

Date:

Returned:

Comments:

Chairman's Office:

Date:

Returned:

Comments:

OFFICE OF THE CHAIRMAN  
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Constituent:

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Special Instructions:

Copies To: Pitt      Radke      Panasiti      Nazareth

**COMPLETE THIS SECTION AND RETURN TO THE EXECUTIVE CORRESPONDENCE UNIT,  
OFFICE OF THE CHAIRMAN, ROOM 6106, STOP 6-1**

Drafted By:

Phone: ( )- -

Division Approval:

Date:

Comments:

**CHAIRMAN'S OFFICE REVIEW**

Legislative Affairs:

Date:

Returned:

Comments:

Chairman's Office:

Date:

Returned:

Comments:

**FYI**

ES99347

**BERNARD L. MADOFF**  
INVESTMENT SECURITIES LLC  
885 Third Avenue New York, NY 10022

212 230-2424  
800 334-1343  
Fax 212 486-8178

Bernard L. Madoff

November 1, 2002

The Honorable Harvey L. Pitt  
Chairman  
U.S. Securities & Exchange Commission  
450 Fifth Avenue  
Washington, DC 20549

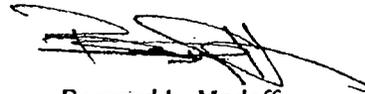
Dear Chairman Pitt:

On behalf of our firm and the securities industry, I would like to thank you and your fellow Commissioners for providing us with the opportunity to participate in the recent SEC Roundtable on Market Structure.

Our marketplace is undergoing significant changes, many of which will have a profound impact on the competitive environment for securities markets both here and abroad.

We look forward to continuing the dialogue and would like to invite you and your staff to visit our offices at your convenience.

Sincerely,



Bernard L. Madoff

cc: Annette Nazareth  
Robert Colby  
Lawrence Harris

Affiliated with:  
Madoff Securities International Limited  
12 Berkeley Street, Mayfair, London W1X 5AD. Tel 020-7493 6222

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ES99347

**BERNARD L. MADOFF**  
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885 Third Avenue New York, NY 10022

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800 334-1343  
Fax 212 486-8178

Bernard L. Madoff

November 1, 2002

The Honorable Harvey L. Pitt  
Chairman  
U.S. Securities & Exchange Commission  
450 Fifth Avenue  
Washington, DC 20549

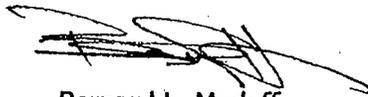
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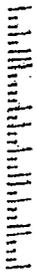
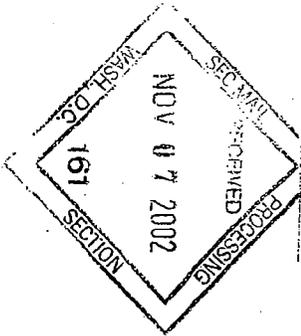
Bernard L. Madoff

cc: Annette Nazareth  
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Lawrence Harris

Affiliated with:  
Madoff Securities International Limited  
12 Berkeley Street, Mayfair, London W1X 5AD. Tel 020-7493 6222

**BERNARD L. MADOFF**  
**Investment Securities**  
885 Third Avenue New York, NY 10022

The Honorable Harvey L. Pitt  
Chairman  
U.S. Securities & Exchange Commission  
450 Fifth Avenue  
Washington, DC 20549





THE CHAIRMAN

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

August 14, 2002

Mr. Bernard L. Madoff  
Mr. Peter B. Madoff  
Bernard L. Madoff Investment Securities LLC  
885 Third Avenue  
New York, NY 10022

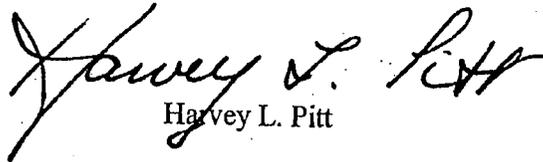
Dear Bernie and Peter:

Thank you for your recent letter regarding SuperMontage and Nasdaq's exchange registration. The Commission recently approved the NASD's Alternative Display Facility on a pilot basis until next April. The ADF is intended to satisfy a statutory requirement under the federal securities laws that the NASD encourage fair and informative quotations by its members and is one of the preconditions to the operation of SuperMontage. The Commission will consider the extent to which the SuperMontage preconditions have been satisfied at an open meeting currently scheduled for August 27th.

In addition, Nasdaq has filed with the Commission several proposed rule changes that modify the operation of SuperMontage, which Nasdaq has represented as necessary for its launch. I assure you that the Commission and its staff are working diligently to resolve any outstanding issues that may arise from these filings as well as from Nasdaq's pending exchange registration.

Thank you again for your letter.

Yours truly,

  
Harvey L. Pitt

OFFICE OF THE CHAIRMAN  
**Correspondence Tracking Sheet**

Date Assigned: 07/16/2002 Control #: ES96620  
Date Of Corres: 07/08/2002 Master #: 718472  
Due Date: 07/22/2002 Contact Type: US MAIL  
Assigned To: Annette Nazareth MR  
Action Required: Prepare Response for Chairman's Signature  
Correspondent: BERNARD L. MADOFF  
Title: \_\_\_\_\_  
Affiliation: \_\_\_\_\_  
Constituent: PETER B. MADOFF  
Subject: SUPERMONTAGE AND NASDAQ EXCHANGE REGISTRATION  
Special Instructions: \_\_\_\_\_  
Copies To: Pitt Panasiti Bussey Richards

COMPLETE THIS SECTION AND RETURN TO THE EXECUTIVE CORRESPONDENCE UNIT,  
OFFICE OF THE CHAIRMAN, ROOM 6106, STOP 6-1

Drafted By: Kelly Ritey Phone: ( ) - -  
Division Approval: \_\_\_\_\_ Date: 8/14/02  
Comments: \_\_\_\_\_

**CHAIRMAN'S OFFICE REVIEW**

Legislative Affairs: \_\_\_\_\_ Date: \_\_\_\_\_ Returned: \_\_\_\_\_  
Comments: \_\_\_\_\_  
Chairman's Office: \_\_\_\_\_ Date: 8/14/02 Returned: 8/14/02  
Comments: \_\_\_\_\_

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**BERNARD L. MADOFF**  
INVESTMENT SECURITIES LLC  
885 Third Avenue New York, NY 10022

65 74020

212 230-2424  
800 334-1343  
Fax 212 486-8178

July 8, 2002

The Honorable Harvey L. Pitt, Chairman  
The Honorable Cynthia A. Glassman, Commissioner  
The Honorable Isaac C. Hunt, Jr., Commissioner  
U.S. Securities and Exchange Commission  
450 Fifth Street, NW  
Washington, DC 20549

Re: SuperMontage and Nasdaq Exchange Registration

Dear Commissioners,

Bernard L. Madoff Investment Securities, LLC (BLMIS) would like to take this opportunity to once again express its support for Nasdaq's future Order Display and Collector Facility, also known as SuperMontage, and also for the approval of the Nasdaq Stock Market's pending exchange registration. We strongly believe these initiatives to be among the most positive and beneficial developments involving the evolution of the equities market in the U.S. in quite some time, and look forward to their ultimate implementation and approval. Consequently, we urge the Commission to ensure that these two initiatives move forward without any further delay.

### **Our History with Nasdaq**

BLMIS is a leading international broker-dealer. The firm has been providing quality executions for broker-dealers, banks, and financial institutions and their respective customers since its inception in 1960. With \$400 million in firm capital, Madoff currently ranks among the top 1% of US Securities firms.

Much of our success has been dependent on the Nasdaq Stock Market. BLMIS has been a Nasdaq market participant since that market's inception in 1971. In fact we were one of the five pilot firms that initiated trading on Nasdaq. We have participated in virtually every new initiative undertaken by Nasdaq to enhance the system and its marketplace. With rare exception, these initiatives have always resulted in greater transparency, better execution quality, enhanced functionality, increased performance and reliability, and thus has redounded to the benefit of the investor and the U.S. markets in general. Nasdaq's dedication to market quality has produced one of the most respected marketplaces in the world. It has provided an environment for corporate development and capital formation that is unparalleled in the global marketplace, and is the envy of markets everywhere.

One of the keys to Nasdaq's success has been its commitment to help all its broker dealers market participants, no matter how large or small, to service the investing public by interacting as either agent or principal on behalf of the retail and

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12 Berkeley Street, Mayfair, London W1X 5AD. Tel 020-7493 6222

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institutional customer community. The services that we as intermediaries provide ensures these investors maintain unparalleled cost effective access to Nasdaq and exchange-listed securities, with all the benefits of the latest developments in regulatory and competitive market structure, including the most sophisticated technological advancements available. The Nasdaq system has been and continues to be an integral part of our firm's growth and development, as it has been for many others.

### **Importance of SuperMontage**

Further to its role in providing this central core of technology for the benefit of the investing public, we sincerely believe Nasdaq's soon to be implemented SuperMontage system will prove to be the most important new innovation in market structure to be offered to its members since its first offering of the Nasdaq system. SuperMontage holds out the potential for Nasdaq market participants and their customers to benefit from enhanced levels of quote transparency and speed of execution, along with a broad menu of execution priorities defined by the order provider. It also provides a vast array of quote and order display options for market makers to assist them in meeting their order display requirements on behalf of their customers. All of this has been built on a new scalable infrastructure, and should be delivered on one of the most robust networks in the financial services industry. The most important benefit, we believe, will be the centralization of trading interest and ease of access for broker dealers. We believe that this is a critical component to assist all broker-dealers in meeting their fiduciary and regulatory obligations of providing "best execution" as defined by the Commission and other related legal authority. As the Commission is well aware, these obligations have come under intense scrutiny from both a regulatory and competitive standpoint, following promulgation of SEC rules requiring disclosure of order routing and execution quality information as set forth in SEC Rules 11Ac1-5 and 11Ac1-6.

The fragmentation that has proliferated following both the Order Handling Rules in 1997, and Reg ATS in 1999, in conjunction with the advent of decimalization and a variety of competitive forces has created a highly challenging environment. As a result, Nasdaq market participants have demanded that Nasdaq provide systems that would enable all its members to meet their fiduciary obligations in the most cost effective and efficient manner possible within this evolving market structure. Nasdaq has, and continues to strive to meet the mandate of its members in this context.

For example, Nasdaq implemented SuperSoes, which greatly enhanced access to displayed interest and speed of execution. Nasdaq also recently adopted the Primex Auction System<sup>®</sup>, which we helped develop along with several of the securities industry's largest participant firms. Primex is a hybrid auction/dealer mechanism that allows orders to be systematically exposed to a broad audience, while also providing unique tools to interact with these orders. Primex provides greater opportunities for order interaction, price improvement and enhanced liquidity. We believe that SuperMontage is the next critical step in the evolution of the Nasdaq marketplace because it will for the first time provide Nasdaq market participants with a highly integrated marketplace incorporating the best components of a broad array of execution venues that the U.S. financial markets now demand. While it centralizes all of these attributes within the

Nasdaq environment with a single point of access, it also does so in a way that provides choice in how its participants use it and interact, and most importantly, preserves the competitive environment on which the National Market System is based.

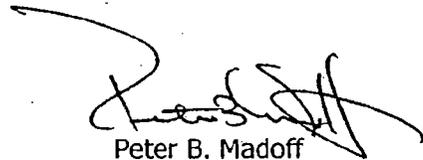
### Conclusion

Nasdaq and its market participants need SuperMontage now. The market cannot afford any further delay. While the Commission has laid down the gauntlet for best execution on behalf of all investors, and rightfully so, it is up to Nasdaq to provide its members with the technological means to satisfy these obligations, and to do so at a fair and reasonable cost within an appropriate exchange environment. We believe that Nasdaq has done this, both with SuperMontage and its initiative to convert to exchange status. While we realize that implementation of SuperMontage is in part dependent on the ADF initiative being introduced by the NASD, we urge the Commission, as guardian of the investor, to do all within its power to ensure that SuperMontage be allowed to proceed as expeditiously as possible.

Sincerely yours,



Bernard L. Madoff



Peter B. Madoff

cc: Annette Nazareth (Director, SEC Division of Market Regulation)  
Robert L.D. Colby (Deputy Director, SEC Division of Market Regulation)  
Hardwick Simmons (Chairman and CEO, Nasdaq)  
Richard G. Ketchum (President and Deputy Chairman, NASDAQ)

\*\*\*\*\*  
OFFICE OF THE CHAIRMAN  
\*\*\*\*\*

DATE ASSIGNED : 01/17/96 CONTROL #: 066783  
DATE OF CORRES. : 01/12/96 MASTER #: 000037060  
DATE DUE : 01/24/96

ASSIGNED TO: MR LINDSEY  
ACTION REQUIRED: PREPARE RESPONSE FOR CHAIRMAN'S SIGNATURE  
CORRESPONDENT: PETER B. MADOFF  
ORGANIZATION: BERNARD L. MADOFF - INVESTMENT SECURITIES  
CONSTITUENT: \_\_\_\_\_  
SUBJECT: COMMENT LTR RE PROPOSAL TO ENHANCE NATIONAL MARKET SYST  
SPECIAL INSTRUCTIONS: FILE NO. S7-10-95  
COPIES TO: LEVITZ SCHLEIN DWYER KATZ

\*\*\*\*\*  
COMPLETE THIS SECTION AND RETURN TO EXECUTIVE CORRESPONDENCE  
ASSISTANT OFFICE OF THE CHAIRMAN ROOM 6010, STOP 6-1  
\*\*\*\*\*

DRAFTED BY: DAVID DESTIGUEL PHONE: 10173  
DIVISION DIRECTOR APPROVAL: [Signature] DATE: 1/19/96  
COMMENTS: \_\_\_\_\_

CHAIRMAN'S OFFICE REVIEW  
REG. SECRETIVE/ALTERNATE: \_\_\_\_\_ DATE: \_\_\_\_\_  
CHAIRMAN'S OFFICE: R. LONG DATE: 1/19  
COMMENTS/CHANGES: OK REC 1/19



THE CHAIRMAN

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

January 29, 1996

Mr. Peter B. Madoff  
Bernard L. Madoff Investment Securities  
885 Third Avenue  
New York, NY 10022-4834

Dear Peter:

Thank you for your kind note and the copy of the firm's comment letter regarding the Commission's Order Execution Obligations Proposal. I certainly appreciate the time and effort you and Bernie have devoted to reviewing and commenting on the Proposal. Please send my regards to Bernie.

Sincerely,

  
Arthur Levitt



**BERNARD L. MADOFF**  
**Investment Securities**

885 Third Avenue New York, NY 10022

0667F3

Dear Arthur,

Bernie and I  
look forward to  
your comments

Best wishes  
for a healthy and  
happy New Year

Regards  
Peter



**BERNARD L. MADOFF**  
**Investment Securities**

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January 12, 1996

Mr. Jonathan G. Katz  
Secretary  
United States Securities and Exchange  
Commission  
450 Fifth Street, N.W.  
Washington, DC 20549

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OFFICE OF THE CHAIRMAN

**Release No. 34-36310; File No. S7-30-95**

Bernard L. Madoff Investment Securities appreciates the opportunity to comment on and is pleased to support the Securities and Exchange Commission ("SEC" or "Commission") proposals for Order Execution Obligations. These proposals are necessary and important enhancements to the National Market System ("NMS") as called for by Congress in its adoption of the Securities Acts Amendment ("1975 Amendments"). The Commission proposals will facilitate competition and focus technology to provide greater quote transparency, liquidity and confidence in an NMS that is already the envy of securities markets around the globe.

Madoff Securities has been a market maker for thirty-five years. Our firm was one of the first to enroll in Nasdaq. We have participated in virtually all aspects of the NMS evolution for Nasdaq and exchange listed securities. Madoff's willingness to employ new technology during the past 20 years has enabled the firm to seize the opportunities for competition mandated in the 1975 Amendments. In that time we adopted standards that met or exceeded the order execution obligations now being proposed by the Commission. These standards are the hallmark of our commitment to provide superior executions and quality services to broker-dealers catering to the retail investor.

Our experience with regard to the specific aims, the benefits derived and the costs incurred from the implementation of the Commission proposals leads us to enthusiastically support the SEC's intent with some suggested modifications to the proposed rules.

**Transparency Demands Expanded  
Quotation Requirements**

We commend the proposal to amend Rule 11Ac1-1 ("Quote Rule"). By expanding quotation requirements to now include substantial market makers and

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MADOFF\_EXHIBITS-05488



specialists in all exchange listed securities, the SEC will ensure that the best bid and offer prices are available to public investors. This proposal strengthens and reinforces the intent of the 1975 Amendments, which sought to improve published quotation information.

The extension of mandatory quotation requirements to all NMS participants making markets in listed securities is fair and reasonable. Applying the proposal's one percent aggregate volume threshold is the necessary and proper adjustment to the Amswiss exemption (Release No. 15757, dated April 19, 1979). That release provided for voluntary quotation requirements for market makers and specialists trading securities listed on exchanges prior to April 1979 (non-rule 19c-3 securities). The voluntary nature of the rule leads to abuses by many OTC market makers. They take advantage of the exemption and choose not to publish quotations even though they are doing significant business in those securities. Those who do publish quotations, providing transparency and liquidity, suffer a competitive cost disadvantage. The reimposition of quotation requirements for all significant OTC market makers will level the playing field for all market makers while elevating the quality of the NMS for all listed securities.

The Commission's proposed expansion of the definition of who is an OTC market maker would now extend to firms who did not deem themselves market makers in the past. This change is equal in importance to the one percent aggregate volume threshold in achieving the SEC's ultimate goal of greater transparency and more accurate information for public investors. The new proposal would treat any broker-dealer holding himself out as regularly willing to transact business for his own account in certain securities as a market maker in those securities and therefore require him to publish quotes. It would apply without regard to whether the market maker transacted business solely with his own customers or with other firms' customer order flow. Many of the firms to be covered by the expanded definition consider it unnecessary to publish regular and continuous quotations. Yet they transact significant volume in these securities. As with the one percent rule, this proposal broadens the definition of who should be required to provide transparency and liquidity to the National Market System. It also ensures a minimum level of quotation commitment from those NMS participants vying for public order flow.

#### Expand NASD Access To ITS

The NASD has been denied expanded access to the ITS system for all listed securities in previous requests. Other exchange competitors objected to the NASD's equivalent access and participation in ITS for OTC market makers in listed securities, on the basis that many OTC market makers were not publishing quotations. They also pointed out that NASD rules did not mandate that all OTC market makers abide by trade-through rules and other ITS requirements. It is indeed ironic to note that by continuing to exclude OTC market maker quotes in



non-rule 19c-3 securities the ITS link exchanges are free to trade through these quotes with impunity under existing exchange trade-through rules. There is simply no valid excuse or justification for this denial of equivalent access by OTC market makers or the obstruction of their ability to reach superior quotations, where they may exist, through the ITS facilities, to comply with their best execution obligations. The NASD has responded to these concerns and implemented rule changes that now require every OTC market maker to conform with NMS principles. All NASD broker-dealers must respect other NMS quotations in listed securities and not trade through superior price quotations in the National Market System.

The SEC's imposition of mandatory quotations would require OTC market makers who exceed the one percent threshold -- even those firms who previously did not consider themselves market makers -- to register as a Consolidated Quotation System ("CQS") market maker and publish quotations in Nasdaq. By participating in CQS, these firms will be in compliance with standards equal to that of any other market. These requirements add greater transparency and liquidity to the OTC listed marketplace as well as the NMS. Furthermore CQS market makers are required to participate in the ITS system for those ITS eligible securities which they are quoting. CQS rules require compliance with ITS trade-through rules which protects the integrity of other ITS participants' quotations.

The adoption of the Commission's mandatory quotation requirements and the subsequent registration of all significant market makers in CQS should sweep away any objection to the NASD's equivalent participation in ITS.

#### End Auto Quote Tracking

Many of the specialists on regional exchanges today quote the securities they trade by using automated quotation devices that predominantly mimic the primary market, providing little, if any, regular price competition or liquidity. These minimal quotations, fixed at 100 shares by ITS rules, are all that are necessary for the regional specialist to reap the benefits of ITS participation. They also can be legally ignored under ITS trade-through rules. The SEC has noted that it is not unusual for regional exchanges to disseminate quotations, presumably generated by computers, that are 1/8 below the national best bid and 1/8 above the national best offer. They also note that the proliferation of these insignificant quotations strain other exchange and vendor systems which must process all of these quotations.

Auto quote tracking often results in "fair weather market making." Because these quotes are often meaningless and inaccessible, specialists tracking quotations can convey a false sense of liquidity. This problem is especially pronounced at times when markets for securities are volatile and in



need of market maker and specialist commitment. Quotations are meaningless when they are pegged to prices of other markets in a manner that will always generate a quotation of lesser value than other available quotations. Furthermore auto tracking quotes cannot be deemed accessible if they are programmed to change in value in a manner that shadows the quotations of the primary market.

#### Allow Limited Use Of Computer Generated Quotations

The Commission has noted that the imposition of its mandatory quotation requirement for OTC market makers raises the issue of whether or not to revise the NASD's restrictions on certain computer generated quotations. The NASD has appropriately differentiated between auto quote tracking and computer generated quotations. With due regard for the inherent problems associated with auto quote tracking, the NASD has provided for the limited use of computer generated quotations in specific, clearly defined circumstances: (i) to allow a market maker to adjust a quote size or reenter a new price *after an execution*, (ii) to reflect or adjust a customer limit order and (iii) to reflect a better quote to seek price improvement.

This approach provides for the significant use of technology to enhance transparency, to promote price discovery and to allow market makers to adjust their markets appropriately after an execution against their quote. There may be other valid instances where computer generated quotations are acceptable and do not create the unnecessary volatility, illiquid markets or severe systems overhead that so often accompanies auto quote tracking.

We must not lose sight of the rules' intent to enhance the quality and integrity of the information supplied to the public in NMS quotations. Exchange specialists and OTC market makers in listed securities, as well as all market makers in Nasdaq securities, should be willing to provide meaningful, competitive and accessible quotations to public investors without the use of auto quote tracking technology. To do otherwise would demean the integrity of the marketplace.

#### **Market Maker And Specialist Quotations Must Include Best Prices**

Many market makers and specialists have adopted the practice of placing superior priced orders in electronic communication networks ("ECNs") without including these better prices in the quotation display of their self-regulatory organization ("SRO"). The Commission is right to be concerned that small investors may not have knowledge or access to the best available price. The



imposition of a "best price" standard in which every market maker or specialist would be required to broadly display their best prices to all public investors in its SRO-sponsored quotation will ensure the integrity of price discovery based on quotations in the National Market System. When all NMS participants reflect their best prices, everyone benefits.

By extending the application of the best price requirement to even de minimis market makers (those not required to quote due to the one percent volume exemption), the Commission closes a loophole that allowed de minimis market makers to use ECNs for intermittent order exposure. Since these orders were not previously mandated to be exposed in NMS quotes, public investors not privy to ECN quotes were denied access to better prices. The Commission's broad application of the best price requirement will increase transparency and encourage all market makers and specialists to consider regular and continuous quotations.

The SEC proposals would require a de minimis OTC market maker in listed securities who used an ECN to also publish that best price in a quotation in Nasdaq. Once he enters a quote, Nasdaq rules would require that OTC market makers maintain regular and continuous quotations. The NASD has every right to implement more strict and demanding standards than the Commission has implemented as long as these standards are fair and reasonable. Regional exchanges have also imposed stricter quotation standards than the SEC's current rules by not allowing regional specialists to avail themselves of the Amiswiss exemption. It does not appear that the NASD's present rule is contradictory to the intent of the 1975 Amendments and the Commission proposals. It would in fact increase transparency and enhance price discovery in the NMS.

The NASD rule requiring market makers who publish a quotation to continue to publish regular and continuous markets is necessary and appropriate to maintain fair and orderly markets, and to have reasonable expectations for market maker continuity and capital commitment. Nasdaq market makers must comply with this requirement when trading Nasdaq equities. It does not seem unreasonable to require de minimis OTC market makers in listed securities to publish their best prices in Nasdaq as well as on ECNs. The price of being a market maker should be regular and continuous quotations.

#### Display Of Size Should Be Optional

We agree with and support the Commission's recognition that the best price published in ECNs must be shown in a market maker or specialist quote. We also agree that they should only be required to display the minimum quotation size established by their exchange or association. Price transparency is paramount and it will be achieved more readily if NMS participants are given

the freedom to decide how much size to show with a given order. The Commission has correctly recognized that mandating that the entire size of the order be shown could result in the front running of large orders by other NMS participants to the disadvantage of market makers or specialists exposing the order. By allowing NMS participants the option to reflect only a part of the order, there should be little, if any, resistance to placing all superior priced interest within quotations.

#### Anonymity & ECNs

Specialists and market makers can still choose to use ECNs to achieve anonymity for the incremental size not shown alongside their quote. The desire to seek anonymity has become an important element in the growth of ECNs. Many market participants are greatly concerned that the identity of the entity placing an order conveys too much information. Allowing NMS participants the ability to show some incremental representative size, rather than the total size of the order, is the proper compromise. This allows the marketplace to see the best price at which orders exist without compromising the individual dealer's ability to achieve best execution. Market participants may choose to reveal a part of the size and assume the risk of how much or how little is exposed. If an ECN is chosen for its anonymity or liquidity characteristics, it will not hinder the price discovery process. The choice of which marketplace or system is used becomes irrelevant to price discovery since all broker-dealers, market makers and specialists would be bound by uniform order price exposure requirements.

#### Uniform Minimum Increments For Quotations Are Necessary To Achieve Fair And Orderly Markets

An important corollary issue to mandatory "best price" order exposure for all NMS participants is the definition of minimum increments for order exposure in quotations. Marketplaces such as the New York Stock Exchange and Nasdaq find it necessary and appropriate to establish minimum quotation increments in the interest of fair and orderly markets. These increments reflect the capitalization and trading characteristics of the subject securities as well as the capital commitment and trading risk of the specialists and market makers. Minimum quotation increments also promote reasonable expectations for the price and time priority of limit orders. These quotation increments are reviewed by NMS participants through their ITS user groups and trading committees.

Although it is important for the Commission to support the imposition of uniform minimum quotation increments, it would be wrong for the Commission to try to impose its view of what those increments should be. That is for the primary market, where the security is traded, to decide. Dealer markets may have need for smaller minimum quotation increments due to decentralized price-time priorities. Whatever appropriate increment is chosen, it would be applicable to





all broker-dealers and specialists who make markets in that security. It should also apply to all internal broker-dealer routing or execution systems.

Minimum increments should also apply to continuous auction systems that attempt to provide immediacy and liquidity in competition with SRO-sponsored markets. Standard quote increments would prevent some NMS participants from seizing price priority by jumping ahead of other orders through posting nonstandard quotes in systems not currently bound by standard minimum increment quotations. Price fragmentation, one of the major abuses of the price discovery process, would end if marketplaces refused to allow nonstandard increments to be published in continuous auction systems. Nonstandard quotation increments can exist in single-priced auction and crossing networks where critically important issues of immediacy and capital risk are not factors in defining quotation standards.

Although primary market participants would establish their own minimum quote increments, competition to produce smaller quotation increments can still emanate from other primary marketplaces seeking listings and order flow. To be successful and attract significant business, they will also have to provide similar, if not greater, liquidity and investor fairness. This competition will drive the minimum quotation increments to a level that encourages investor confidence as well as market maker and specialist capital commitment.

The Commission's role in achieving fair and orderly markets should not focus on reducing minimum quotation increments. It should instead encourage the fairness and the constant review of uniform quotation increments by NMS participants that will ensure competitive prices and liquidity in the NMS.

#### **Display Of Best-Priced Limit Orders By All NMS Participants Should Be Mandatory**

True price discovery and fairness for public investors can only be achieved when best price limit orders of all NMS participants are reflected in the National Best Bid and Offer ("NBBO"). This is a critical component of the Commission's proposal, without which the NMS fails to reflect the true investor interest in the subject security. We believe the same rationale that mandates specialist and OTC market makers to reflect their best prices in their NMS quotation dictates that all customer limit orders held by broker-dealers must contribute to the accuracy of and confidence in the NBBO.

There should be an absolute requirement for broker-dealers to expose the best price of any customer limit order that equals or improves the market for that security. There is no reason to allow any customer to exclude the price of his order from the NMS in the process of price discovery. No customer -- retail or



institutional -- should be able to free ride or exploit the information provided by other participants in the marketplace.

Broker-dealers who are not market makers or specialists should also be required to contribute best price limit order information to the NBBO by transmitting their orders to a specialist or market maker who is in compliance with the requirement. This would preclude customers from seeking out broker-dealers who are not market makers or specialists and thereby avoid contributing to best price disclosure. If a customer wishes the sanction of an NMS broker-dealer fiduciary, he must be willing to contribute to the NMS price discovery process.

#### Display Of Size Should Be Optional

The Commission should not mandate that market makers and specialists must display the total size of customer limit orders. The SEC should allow specialists and market makers some flexibility in choosing the appropriate size to display. By allowing a customer, specialist or market maker the ability to reflect a nominal size there would be little reluctance, if any, to the mandatory display of best price customer limit orders. The market maker or specialist can choose an appropriate representative size for the quotation price, using his knowledge of the current market environment to determine the best execution of the order. If a market maker or specialist chooses to represent a minimum size or something less than the entire size of the order, he should be responsible for executing the entire order once the exposed size is executed. In this manner the dealer chooses whether he wants to act strictly as an agent on behalf of the customer, or whether he wants to assume dealer risk by committing capital to help complete the transaction.

There should obviously be a provision for a customer to demand that their entire order be shown if they so desire. If total exposure becomes the standard for most orders, all market makers and specialists will be engaged primarily as agents, adjusting their costs accordingly for providing these services. It should also be noted that there would be no requirement to provide any liquidity to these orders other than that of market interest attracted to the order at that price.

By allowing a market maker or specialist to enhance profits by assuming dealer risk, the Commission will provide them with incentives to supply liquidity to the market. If market makers and specialists act primarily as agents and only as dealers as a last resort, there will be little incentive to be a dealer. There would also be a much more costly premium for liquidity provided by market makers and specialists in times of need. This should be a major concern of the Commission and Congress when seeking to implement rules that restrict or preclude market makers or specialists from acting as dealers.



The Commission would still be able to achieve best price transparency by allowing NMS participants the option to reflect some minimum size for each order (i.e., 1000 shares) up to a certain cumulative size (i.e., 10,000 shares) at the best price. This approach would require that a market maker or specialist must show the entire size for each order up to the specified minimum share amount. They would always have to show the best price. Once a specified cumulative size is reached at the best price, market makers and specialists would not have to reflect any more size at that price. In this way many small orders held by one dealer would not necessarily be at a disadvantage by the cumulative effect of aggregating the size of his orders. A specialist holding 20 orders of varying sizes at the best price would not have to reveal any size greater than a cumulative 10,000 shares unless asked to by his customers. If market makers or specialists were forced to expose even the minimum size for each order, the resultant size might present a very large size, which may disadvantage all of the orders at that price. Of course the market maker or specialist who chooses to show less than the whole size for all orders accepts the risk of having to complete all of the interest that has not been exposed, upon satisfaction of the representative size exposed at the best price. All small orders for less than the minimum exposure size would of course have to be exposed in the quote until the suggested maximum cumulative size (i.e., 10,000 shares) was achieved.

	<u>Quote</u>	<u>Size</u>
Previous market maker quote	20 x 20 1/4	500 x 1000
Customer order to buy 300 shares @ 20 Market maker must show entire size New quote	20 x 20 1/4	800 x 1000
Customer order to buy 700 shares @ 20 Market maker must show entire size New quote	20 x 20 1/4	1500 x 1000
Customer order to buy 2000 shares @ 20 Market maker chose to only expose 1000 of 2000 shares addition New quote	20 x 20 1/4	2500 x 1000
Customer order to sell 5000 @ 20 1/8 Market maker chose to only expose 2000 of 5000 shares @ 20 1/8 New quote	20 x 20 1/8	2500 x 2000
Customer order to sell 20,000 @ 20 1/8 Market maker chose to only expose 8000 addition @ 20 1/8 which brings him to optional maximum size New quote	20 x 20 1/8	2500 x 10,000



### Total Layoffs Create "Fair Weather Market Makers"

The proposal should not allow market makers and specialists to lay off entire limit orders in another market. This restriction would prevent them from choosing to be "fair weather market makers and specialists" who only seek market orders or immediately executable limit orders when it suits them. If they are allowed to place best-priced limit orders in other markets or systems, market makers and specialists could choose not to commit any capital to their customers or their quotations. They would in effect be able to selectively withdraw from the NMS. This would create a false sense of liquidity with regard to the number of markets and specialists willing to commit their capital on a regular basis. It would condone something less than minimum levels of dealer commitment to the NMS.

Market makers and specialists should be able to represent a portion of the size in other markets and electronic communications systems for anonymity, but best price and some of the size must be reflected in their NMS quote as well. This would preclude the need to require broker-dealer sponsored ECNs to provide their best prices to the NMS unless the best prices in the system are not those of specialists, market makers or others who are obligated to reflect their best prices in their quotation. As already stated, we believe that all orders retained by NMS broker-dealers, even those not held by market makers or specialists, must be included in the NBBO. All orders must contribute to the price discovery process.

### The Commission Should Propose Rules To Require Trade-Through Protection For All NMS Quotations

The mandatory quotation and order exposure rules proposed by the SEC will be more meaningful if the Commission requires trade-through protection for all NMS quotations. This additional rule would ensure the integrity of the NBBO and provide incentives for market makers to expose their best size as well as best prices. The current ITS plan provides for limited trade-through protection for ITS participants in listed securities. It does not preclude a trade at an inferior price to the NBBO. In the event of a trade through, there is no assurance of execution and satisfaction for the quotation that has been ignored. The process is subjective, cumbersome and in need of improvement.

The Nasdaq stock market offers no protection to market maker quotations that are traded through by other Nasdaq market participants. The NASD's latest proposal only provides for limited trade-through protection for those orders placed in its N'Aqcess limit order file. These proposed changes are inadequate. They must be superseded by an SEC requirement to protect all NMS quotations if the NBBO is to be considered meaningful.



## Automated Execution Capability For NMS Market Makers And Specialists

Specialists and market makers who provide regular and continuous NMS quotations should have immediate automated execution capabilities within each other's markets so that they can satisfy customer limit orders and better prices embodied in their competitors' quotations. Prior attempts to provide this type of access between NMS competitors met with great resistance. The Commission's desire to increase transparency makes this interaction between marketplaces a worthy addition to the SEC proposals.

By providing for automated execution between quid pro quo competitors, the Commission creates another incentive for market makers and specialists to contribute regular and continuous quotations. Market makers and specialists would have automated execution capabilities similar to that being used against them by some NMS professionals operating under the guise of public customers. Using technology, market makers can easily and quickly adjust their quotations in the event of an execution or order cancellation. There is no longer any reason to withhold this benefit from competing specialists and market makers who share similar obligations and responsibilities within the NMS.

### **Price Improvement: SEC Clarification Of Best Execution Would End Controversy**

The issue of price improvement for customer market orders has become one of the major marketing tools for NMS participants seeking to attract order flow. There has been a great deal of rhetoric and subjective statistical data used by many participants to substantiate the level of price improvement obtained in their respective markets. Although the opportunity for price improvement is certainly important, it would not be as significant if all NMS participants were presently required to expose their best-priced orders -- customer and proprietary -- in the NMS NBBO. If the Commission adopts these aspects of the proposals, it would go a long way towards narrowing the quotation spreads to such a degree that there would be little opportunity for price improvement based on a quotation greater than the minimum increment.

Many years ago, as competition among NMS participants became a reality, order flow was diverted to markets offering inducements of more efficient technology, speed of execution, lower costs and better service as well as best execution at the NBBO. The primary markets for listed securities, rather than compete to provide equal if not greater efficiencies and inducements, chose to disparage the quality and integrity of executions at the NBBO. They began to raise questions and doubts about automated executions that were priced to



compete with NMS-exposed best bids and offers. Ironically, they were even calling into question the integrity of their own quotations. They implied that it was possible that primary market quotations may not actually be the best price available. The primary listed markets implied that only through routing orders to them could one hope to achieve a fiducially responsible execution. Only their specialist or their floor brokers in the crowd could learn what were the best prices. They were able to "improve" on their own best prices due to stock exchange rules that give specialists and floor brokers a great deal of latitude as to when and how orders must be exposed in the quote. This subjectivity allows them to achieve a competitive advantage over other NMS competitors who were not privy to price information contained in those orders concealed from the NBBO. It also gave those specialists and floor brokers who chose not to reveal their best price in the quote the opportunity for a second chance to step ahead of limit orders that had price priority based on the NBBO. All of these executions at prices better than the prevailing NBBO were labeled with the misnomer of price improvement. Consequently, price improvement has become one of the most contentious and misconstrued issues of the NMS.

The SEC must take some of the responsibility for the confusion and debate over best executions at the NBBO and the supposed need for price improvement. The Commission's prior rulings gave too much latitude on issues of mandatory quotations and best price limit order exposure, creating confusion and doubt as to what is considered a fiducially responsible execution.

#### The NMS Must Adopt Uniform And Consistent Standards For Price Improvement

The SEC has defined "price improvement" as the execution of an order at a price better than the existing NBBO. It further states that the rule would apply in those instances where the spread between the NBBO is greater than the minimum quote variation. The "minimum variation" is defined as the minimum increment by which a covered security may be quoted on the primary market for the security. This rule proposal clearly defines what price improvement is and when it is appropriate to provide price improvement opportunity for customer orders. It is very important that all NMS participants adopt uniform and consistent standards for price improvement to ensure fairness and provide quality executions for customer orders, not to mention to end the disparaging rhetoric that has become an unnecessary by-product of the competition for order flow.



### There Cannot Be Price Improvement In Minimum Increment Markets

Some markets claim to achieve price improvement possibilities in minimum increment markets (i.e., 20 1/8 x 20 1/4). This is misleading and unfair. If there is price improvement potential in a minimum increment market, it is at the expense of a previously exposed order that erroneously believes it is first in line to interact with the next market order delivered to that market. Even if that queued order eventually gets an execution, *and it may not*, the fill comes later than when it might otherwise have occurred. The delay creates direct costs and opportunity costs associated with the motivation of that customer's order. This practice allows a specialist to choose to pass over a limit order that was entrusted to him as a fiduciary in favor of providing price improvement to another customer. Price improvement in minimum increment markets condones subjective conduct that has the potential for favoritism towards some customers at the expense of others. Conduct which demeans the integrity and price priority of limit orders that comprise a market's quotation is contrary to the intent of the Commission's proposal to make quotations more meaningful. This should certainly not be classified as price improvement.

The SEC must not allow competing market centers to choose different standards and definitions for price improvement when NMS participants are competing for order flow based on execution standards deemed to be appropriate for everyone. It is the Commission's responsibility to ensure that all markets adopt uniform standards for comparison.

### There Must Be Uniform Minimum Increments For Price Improvement

Another important standard that needs to be established is a uniform minimum increment for price improvement. This is necessary so that markets provide fair and orderly expectations for limit orders, especially in view of the Commission's proposal for mandatory order exposure. Unless minimum increments are defined for price improvement, nominal price improvement (i.e., \$.01 or \$.02) can be offered for a market order so as to step ahead of a limit order that expected to benefit from its priority and exposure in the marketplace. These limit orders have been entered with respect to and in compliance with minimum quotation increments as previously discussed. These quotation increments have been determined and agreed upon by all market participants with regard to market characteristics and investor fairness. It would behoove the Commission to establish significant price improvement increments that respect limit order standing. The SEC must level the playing field upon which market orders and limit orders compete for priority.



- Ex. 1            20 1/8 x 20 1/4  
- Minimum increment for quotations in XYZ is 1/8. Therefore no price improvement opportunity.
- Ex. 2            20 1/8 x 20 3/8  
- Minimum increment for quotation in XYZ is 1/8. Therefore price improvement opportunity is appropriate.  
  
- Suggested minimum increment for price improvement in this example should be 1/8 since that would be the next possible quotation improvement possible and does not jeopardize the priority of orders at the inside quote.
- Ex. 3            4 1/8 x 4 1/4  
- Minimum increment for quotation in ABCD is 1/16. Therefore price improvement opportunity is appropriate.  
  
- Suggested minimum increment for price improvement in this example should be 1/16 since that would be the next possible quotation improvement possible and does not jeopardize the priority of orders at the inside quote.

By establishing price improvement increments that are equal to the minimum quotation increment, the Commission would ensure the integrity of the price priority of the limit order in each market's quotations. Significant price improvement increments will discourage NMS participants from holding back limit orders that could improve the NBBO. These participants no longer could rely upon the concept of price improvement increments, giving them a second chance to step ahead of limit orders already in the quote.

#### Exceptions

Any rule to require price improvement opportunity for customer market orders should rightfully have many of the exceptions cited in the proposal. Odd lots, orders of block size as well as orders delivered during SRO declared "fast markets" do not require such treatment. Customer market orders received within five minutes of the open or close of that security should also be excluded. It also seems prudent to exclude orders where the spread between the NBBO is four times greater than the minimum variation if that market complies with the mandatory quotation and order exposure requirements. The fact that such a wide spread remained in those securities implies limited liquidity or investor interest. There would appear to be little likelihood of achieving price improvement in that security. There may be other appropriate exceptions. Market makers and specialists must be given the necessary latitude, mindful of



their fiduciary obligation, to define circumstances where price improvement opportunity is not warranted.

#### Limited Price Improvement For Nasdaq Securities

The Commission is correct to limit the applicability of the rules for those Nasdaq securities that fall below a volume threshold based on average daily volume. Many Nasdaq securities do not have enough order flow to provide a likelihood of price improvement. Our experience with providing price improvement in Nasdaq securities would lead us to support the Commission's extension of the price improvement requirement to a small group of Nasdaq securities.

We are unsure whether 250 may be too large a number. Competition and experience over a reasonable period of time will define the appropriate number. We also question the methodology by which securities would be chosen. The use of the highest average daily trading volume over the previous quarter may not be the best way to select a representative group. Consideration must also be given to transaction volume and the dollar value of those transactions. This helps to eliminate many high-volume, low-priced securities that may not be appropriate candidates for price improvement.

#### Price Improvement Has Nothing To Do With Payment For Order Flow Or Internalization

By establishing NMS standards for order handling and execution obligations, the SEC proposal separates the question of execution quality from that of where the order was executed. It does not matter whether a customer order receives payment for order flow or is internalized. The broker's fiduciary responsibility and market characteristics should determine whether price improvement opportunity is applicable.

#### **Competition And Fiduciary Responsibility Are The Best Safe Harbors**

Past experience has demonstrated that many safe harbors have become de facto rules. It is important not to lose sight of the fact that this price improvement safe harbor is only one method of achieving effective and meaningful price improvement. Competition and fiduciary commitment will provide suitable alternative methods to establish the availability of price improvement. The establishment of a non-exclusive safe harbor is beneficial, however, as a means by which a customer, market maker or specialist can gauge whether an order has received a sufficient opportunity for price improvement. There has been too much rhetoric and specious argument about



the quality of executions offered by NMS competitors. Those who wish to ratify their good faith effort to provide price improvement may avail themselves of this safe harbor, an effective but costly endorsement.

#### Significant Costs To Enter Safe Harbor

The safe harbor described in the release is very similar to the price improvement mechanism employed by Madoff for many years. Our system has been very effective in achieving price improvement, producing a significant price improvement for more than half of the orders where an opportunity presents itself.

We decided to build our price improvement system because it became apparent that NMS quotations, especially those of primary markets, were not reflecting their best prices. We saw many quotations where the spreads were greater than the minimum increment for the subject security, yet trades were taking place in between the spread. The realization that the NBBO could no longer be relied upon as the basis for best execution led us to develop our system.

To achieve price improvement, Madoff stops a customer market order whenever the spread is greater than the minimum quotation increment. We then reflect a better price in our quote to seek out the availability of price improvement. Our system has proven to be very effective. It was developed at great cost and entails significant market risk. It was a competitive decision prompted by our desire to attract order flow from retail brokerages who sought to provide their customers quality executions with assurances that price improvement opportunities were fully explored.

Many firms may not be willing or able to assume the risk of stopping the order for any time frame, yet alone build systems that automatically reflect better prices and monitor other markets for confirming price activity. We also choose to assume the risk of stopping our customer's entire order at the prevailing best price, even if the best price did not offer enough size to satisfy our customer's order. We also offer to complete our customer's entire order at the better price that we exposed in our quote, if a confirming event ratified execution at a superior price. These benefits, which exceed what is proposed, were the result of competition.



## Safe Harbor Proposes Double Jeopardy

There are some elements in the Commission's proposed safe harbor that go beyond what we consider fiducially responsible requirements for price improvement. Although the SEC safe harbor provides for many events that will end the exposure in less than the specified exposure period, we do not agree with its suggested treatment of subsequent market orders on the same side of the market. The Commission suggests that a subsequent market order on the same side of the market that arrives during the original exposure period allows for immediate execution of the first order at the stop price. This is appropriate and fair. However, the suggestion to have to reexpose the better price for the second order is unfair in that it imposes double jeopardy on the specialist based on the prior quote, even though he has already executed the first order at that price. It is unfair to require another guaranteed stop on the subsequent order. If anything, the execution of both orders immediately at the stop price would provide significant liquidity and commitment to a quote that may not even be that of the market maker or specialist providing the stop. Immediate execution of both orders would prevent the building of queues for subsequent orders and allows a market maker or specialist to adjust his quote or react to the quote that served as the basis for the stop. The market maker or specialist must be given the opportunity to satisfy competitive quotes establishing the NBBO.

### System Considerations May Preclude Small Orders

The safe harbor may also not be appropriate for small orders (100-500 shares). Stops and quote changes to seek price improvement for small market orders may create unnecessary systems burdens and queues. There may be other methodologies to establish and confirm price improvement for these small orders that do not require stops or quote changes. A necessary caveat is that the alternative approach chosen should be meaningful and not subjective. They should use price improvement increments that are credible and do not detract from fair and orderly market expectations for limit orders exposed in the quote.

Finally, as stated earlier, if "best price" and customer limit order exposure requirements are mandated by this rule proposal, the issue of price improvement opportunity and a safe harbor may not be as relevant or as meaningful. The NBBO for each security should now be comprised of all the defined interest in the marketplace.



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The Congressional vision that foresaw an NMS driven by technological innovation has become a reality. It has produced a marketplace whose hallmarks are capital formation, liquidity and fairness for all NMS participants. Advances in information technology and communications also have been utilized by some NMS participants to capture for their own advantage transparency and liquidity that should be available to all public investors.

The Commission has an obligation to put forward rule proposals that ensure investor fairness. They must not condone, by their passivity, conduct which undermines investor confidence in the NMS. All U.S. marketplaces and their members should be equally charged to provide the transparency and liquidity that promotes investor confidence. These proposals in conjunction with the recommendations we have set forth herein will ensure that the NMS continues to evolve in an environment that removes impediments to competition while providing equal treatment for all its participants.

Sincerely,

Sincerely,

Bernard L. Madoff

Peter B. Madoff



\* \* \*

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Handwritten signature of Bernard L. Madoff.

Bernard L. Madoff

Handwritten signature of Peter B. Madoff.

Peter B. Madoff