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2001 SEC No-Act. LEXIS 190

Securities Exchange Act of 1934 -- Section 10 -- Rule 10a-1

February 9, 2001

[\*1] Bernard L. Madoff Investment Securities LLC

**TOTAL NUMBER OF LETTERS: 2**

**SEC-REPLY-1: SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

February 9, 2001

Bernard L. Madoff  
Chairman  
Bernard L. Madoff Investment Securities LLC  
885 Third Avenue  
New York, NY 10005

Re: Rule 10a-1: Market Maker Execution of Customer Buy Orders  
TP File No. 01- 79

Dear Mr. Madoff:

In your letter on behalf of Bernard L. Madoff Investment Securities LLC (Madoff), dated February 9, 2001, you request that the Commission grant an exemption from Rule 10a-1 (Rule 10a-1) under the Securities Exchange Act of 1934 (Exchange Act). Specifically, you seek relief to permit a market maker to effect short sales in New York Stock Exchange (NYSE) listed securities to execute customer market and marketable limit buy orders at the national best offer regardless of the last sale price reported pursuant to an effective transaction reporting plan (Reported Security). A copy of your letter is attached.

In your letter you make the following representations:

Madoff is a market maker in NYSE listed securities. As a competitive strategy, Madoff offers trade execution for eligible customer orders at a price equal to or better than the National Best Bid

[\*2] or Offer (NBBO). At times, a competing market center may provide a national best offer that is below the previous last reported sale in a security. During those times, Madoff may possess customer market and marketable limit buy orders it seeks to execute at the national best offer. In these instances, Madoff's automated trading system prohibits the execution of a proprietary short sale at the national best offer since such a sale would violate the "tick" test of Rule 10a-1. Madoff's customer service desk traders then must handle the buy orders manually.

You state that the full implementation of decimal pricing has increased the number of price points within the NBBO spread and, as a result, has increased the number of instances in which the national best offer is below the last sale. According to your letter, this has also increased the number of customer buy orders being rejected by your automated trading system because they would violate the "tick" test of Rule 10a-1. You note that this has resulted in an increase in the number of trades handled manually from an average of 10 to 15 per day to approximately 400 per day during the two days immediately following the full implementation [\*3] of decimal pricing.

You state that short sales by a market maker in response to customer buy orders at a price equal to the national best offer do not have the potential for the types of abuses that Rule 10a-1 is designed to address, because a market maker would only be providing liquidity in response to a customer buy order. You state that granting a limited exemption would help a market maker's ability to provide best execution to customer orders in a decimals environment. n1

n1 We note that we do not address best execution considerations in our response. Whether an execution at the national best offer constitutes best execution of a customer's trade will depend on all the facts and circumstances. See Securities Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290 (September 12, 1996).

Response:

Paragraph (a) of Rule 10a-1 covers transactions in any security registered on a national securities exchange, if trades in such security are reported in the consolidated transaction reporting system. A short sale of a Reported Security may not be effected at a price either: (1) below the last reported price of a transaction reported in [\*4] the consolidated transaction reporting system (minus tick); or (2) at the last reported price if that price is lower than the last reported different price (zero-minus tick). Absent an exemption, any short sales of Reported Securities executed by Madoff in response to customer market and marketable limit buy orders must comply with paragraph (a)(1) of Rule 10a-1. A short sale at a price equal to a national best offer that is below the previously reported last sale would not comply with Rule 10a-1.

Based upon your representations and the facts presented, the Commission hereby grants an exemption from Rule 10a-1, on the basis of your representations, but without necessarily concurring in your analysis, to permit registered market makers and specialists that are publishing two-sided quotes in the security on their own behalf or on behalf of customers to sell short to facilitate customer market and marketable limit buy orders at the national best offer. n2 This exemption is limited only to such registered market makers and specialists, and solely for the execution of customer market and marketable limit buy orders at the national best offer. Registered market makers and specialists effecting [\*5] short sales pursuant to this exemption must report their sales as "sell short exempt."

n2 Market makers in Reported Securities must register with the National Association of Security Dealers (NASD). See NASD Rule 6320. Specialists on national securities exchanges may register with the exchange on which they are acting as a dealer. See § 240.11b-1 (Exchange Act Rule 11b-1).

The foregoing exemption from Rule 10a-1 is based solely on your representations and the facts that you have presented, and is strictly limited to the application of this rule to your role in executing customer market and marketable limit buy orders. This exemption does not affect any other provision of the federal securities laws, and is subject to modification or revocation at any time if the Commission determines that such action is necessary or appropriate in furtherance of the purposes of the federal securities laws. Further, this exemption is subject to modification or revocation should the Commission amend Rule 10a-1 in such a manner as to deem the exemption unnecessary or in conflict with any adopted amendments. In addition, all persons relying on this exemption are directed to the anti-fraud [\*6] and anti-manipulation provisions of the federal securities laws, including Sections 9(a) and 10(b) of the Exchange Act, and Rule 10b-5 thereunder. Responsibility for compliance with these and any other applicable provisions of the federal securities laws must rest with those relying on the relief granted in this letter.

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

James A. Brigagliano  
Assistant Director

**INQUIRY-1: BERNARD L. MADOFF**  
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February 9, 2001

James Brigagliano  
Assistant Director  
Office of Risk Management and Control  
Division of Market Regulation  
Securities and Exchange Commission  
Mail Stop 5-1  
450 Fifth Street, N.W.  
Washington, D.C. 20549

Re: Exemption from Exchange Act Rule 10a-1

Dear Sir:

Bernard L. Madoff Investment Securities LLC ("Madoff") requests that the Securities and Exchange Commission ("Commission") grant an exemption from the short sale rule, Rule 10a-1 ("the Rule"). Madoff requests a limited exemption pursuant to paragraph (f) the Rule for short sales effected in its capacity as a market maker in New [\*7] York Stock Exchange (NYSE) Listed securities that are executed at the National Best Offer price. Madoff believes that in a decimal-based pricing environment, this requested exemptive relief would allow competing market makers to provide "best execution" of customer orders in an efficient and expeditious manner.

Market makers and specialists are often confronted with providing competitive liquidity at or better than the National Best Bid or Offer (NBBO) which is the product of competing market centers' attempts to attract order flow as well as their compliance with the Display requirements of the Order Handling Rules. It is our understanding that when a competing market center lowered its offering below the previous last sale, other market centers were not entitled to an exemption from the short sale rule in order to passively provide liquidity at the current NBBO and alternatively could ship the order to the market center displaying the best offer or wait for an opportunity to execute the order on an equalizing tick within its own market in order to comply with its "best execution" obligations. As such, Madoff's system is programmed to automatically prohibit market maker proprietary [\*8] short sales in listed securities at a price below a previously reported sale even if to provide passive liquidity and "best execution" to customer market and marketable limit orders at the National Best Offer. Prior to the full implementation of decimalization, this prohibition prevented approximately 10-15 orders a day from having been executed automatically.

In the newly defined decimal environment, the expansion of price points within the spread of the current NBBO increases the incidence of rapidly fluctuating quotation changes, many of which are below the previous last sale. During the first 2 days when the NYSE completed its conversion to decimal-pricing, the prohibition within our system that prevents violations of the short sale rule resulted in approximately 400 orders a day being handled manually by Madoff's customer service desk instead of being immediately automatically executed by Madoff as principal within Madoff's system.

Rule 10a-1 is designed to prevent the market price of a stock (or other "reported security," as the term is defined in paragraph (a)(4) of Rule 11Aa3-1 under the Exchange Act) from being manipulated downward by unrestricted short selling. Madoff [\*9] believes that because this exemption only applies to situations where Madoff is passively providing liquidity to customer orders at the current National Best Offer, the executions effected pursuant to this limited exemption would not be subject to the types of abuses underlying the intent of Rule 10a-1 and would help facilitate market makers' compliance with "best execution." n1 Madoff believes that the immediate granting of this exemptive relief is necessary to facilitate Madoff's, as well as other market makers' and market centers' automated systems ability to provide best execution to customer orders in increasingly active decimal trading environment.

n1 Madoff shall mark the ACT Reports for such executions "sell short exempt."

If you have any questions, or if any aspect of our request requires clarification, please feel free to contact me at 212-230-2424.

Sincerely,

Bernard L. Madoff

**Legal Topics:**

For related research and practice materials, see the following legal topics:

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Law Blue Sky Laws Joint Ventures & Partnerships Securities Law Self-Regulating Entities National  
Association of Securities Dealers