18

liquidnet

Liquidnet, Inc.
498 SEVENTH AVENUE, 12TH FLOOR
NEW YORK, NY 10018
T 646 674 2000 F 646 674 2003
www.liquidnet.com

RECEIVED
JUL 20 2005
OFFICE OF THE SECRETARY

July 19, 2005

By Overnight Courier

Jonathan G. Katz, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-9303

Re: SR-NASD-00-23
Notice of Filing of Amendment No. 2 to Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Amendments to Order Audit Trail System Rules

Dear Mr. Katz,

I am writing on behalf of Liquidnet, Inc. regarding the above-referenced proposed rule change. Liquidnet has no concerns regarding the substance of the proposed rule change, but we believe the proposed implementation period of 120 days for OATS Phase 3 is unrealistic. For the reasons set forth in this letter, we believe that an implementation period of one year would be more appropriate.

Liquidnet is a broker-dealer registered with the Securities and Exchange Commission. Liquidnet operates the Liquidnet trading system, which is regulated as an "alternative trading system" under the Commission's Regulation ATS. Liquidnet also is a member of the NASD.

During the first six months of 2005, approximately 99.75% of our trading volume in NASDAQ securities was fully-automated and reported to OATS. We allow a customer that executes a trade through our system for a portion of its order to telephone us to request that we transmit the residual portion of the customer's order to an ECN or other venue for execution. We estimate that this residual business represents approximately ¼ of 1% of our trading volume. These residual orders are handled manually and thus are not subject to OATS reporting at present, but they would be subject to OATS reporting when Phase 3 of OATS is implemented.

To implement OATS reporting for our manual trading activity, Liquidnet would first need to license an order management system ("OMS"); Liquidnet would then need to develop OATS reporting functionality that accesses the data within the OMS.

As a first step, Liquidnet would need to license an order management system. The order management system would enable Liquidnet's employees who handle residual orders to input the required order data into the order management system. The process of licensing an OMS involves researching the various OMS vendors, negotiating pricing and other terms and signing a contract with the OMS vendor. Part of the research process involves confirming that the OMS allows for capture of all OATS-required data. After the contract with the OMS vendor has been signed, the OMS must be deployed at our site. Liquidnet employees must then be trained on what data to input into the OMS under various scenarios and how the data must be input.

Once the OMS has been installed, Liquidnet must develop OATS reporting functionality that accesses the data within the OMS. This process begins with the Liquidnet product group reviewing Liquidnet's various manual processes and determining what data must be reported to OATS under each trading scenario. Our product group must review these processes against the OATS technical specifications to determine the OATS reports (for example, new order report, routing report, cancel report, cancel/replace report) required under each trading scenario and the data to be input in each field of each applicable report. As you are aware, the OATS technical specifications are more than 250 pages long.

Once the product group has determined the required reports and data, it must document these requirements for the Liquidnet development group. The Liquidnet development group then develops the software code to satisfy these requirements. Liquidnet's development and testing groups work together on an iterative basis. When the development group has completed an iteration of the code, the code is delivered to the testing group. The testing group tests the software for satisfaction with the documented requirements and notifies the development group of any situations where the software does not conform to the requirements (commonly known as "bugs"). After various iterations of this process, when all bugs are fixed, the testing group certifies that the software is eligible for deployment. At this point, the software can be deployed.

As you can see, this is a multi-step process requiring coordination among several departments. Liquidnet, like many other brokerage firms, plans its development schedule months in advance. This means that if software must be implemented on short notice, personnel must be pulled off existing projects. We believe that 120 days is very short notice for this type of coding project. We note that Liquidnet's manual business is relatively simple compared to other brokers, who could have multiple desks involved in equity trading, each with different workflows.

OATS was originally approved in 1998. For a number of years, manual orders have been exempt from OATS reporting. We understand why the NASD wants manual orders to be subject to OATS reporting, and we have no objection to such a requirement. However, it

is important to provide firms with adequate time to implement OATS reporting for manual orders correctly. We believe that the proposed time period could result in firms deploying code that is not fully tested, resulting in inaccurate or missing data. We believe that this would not be in the NASD's best interest. We also believe it would be unfair to the brokerage firms to impose such a short time-frame when inadvertent violations can result in sanctions.

In any event, we believe that the implementation period should start running from the date that OATS makes available any changes to the technical requirements for Phase 3. There could also be a need for NASD Regulation to provide interpretive guidance on issues relating to OATS reporting of manual trades.

As indicated above, we agree that OATS reporting for manual order events is appropriate. However, we believe that the proposed time-frame for implementation is unrealistic. We would be happy to meet with you or representatives of NASD Regulation to provide more detail regarding this matter.

Very truly yours,

Howard Meyerson
General Counsel

cc: Eric LeGoff, Chief Operating Officer, Liquidnet, Inc.