Bloomberg TRADEBOOK LLC

Member NASD/SIPC

January 6, 2003

Via e-mail: rule-comments@sec.gov

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

Attention: Mr. Jonathan G. Katz, Secretary

Re: SR-NASD-2003-173

Ladies and Gentlemen:

Bloomberg Tradebook LLC ("Bloomberg Tradebook") wishes to comment on the above-captioned proposed rule change filed by the National Association of Securities Dealers, Inc. (the "NASD"), through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), which the Commission published for comment in Securities Exchange Act Release No. 48878 (December 4, 2003) (the "Release"). Nasdaq's proposal (the "Closing Cross Proposal") would establish the Nasdaq closing cross for certain Nasdaq National Market securities.

The Closing Cross Proposal has three components: (1) creation of On-Close and Imbalance Only order types; (2) dissemination of an order imbalance indicator via a Nasdaq proprietary data feed; and (3) closing cross processing in SuperMontage at 4 P.M. that would execute the maximum number of shares at a single, representative price that would be the Nasdaq official closing price. In calculating an official price for the closing, Nasdaq would exclude orders of ECNs that do not accept automatic executions on SuperMontage. That is, the closing price would be based solely on the liquidity of auto-execution participants in SuperMontage and would exclude executions of ECNs that have elected to receive order delivery rather than executions.

Nasdaq represents that its Closing Cross Proposal "is designed to create a more robust close that would allow for price discovery, and an execution that would result in an accurate, tradable closing price."[1] At the same time, under the Closing Cross Proposal, to be executable, "all orders and quotes would be required to be subject to automatic execution" on SuperMontage.[2] In effect, requiring automatic execution on SuperMontage for inclusion in the

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[1] *See* Release, Section II.A.1. Purpose.

[2] *Id.*

proposed closing cross would eliminate ECNs from participating in the closing cross. While we support Nasdaq's goal of calculating a reliable closing price, we do not believe it is necessary or appropriate for Nasdaq to exclude ECNs to achieve that goal. Indeed, particularly given the fact that a significant portion of trades in Nasdaq securities occur on ECNs that have elected order delivery rather than auto-execution, the Closing Cross Proposal is more likely to result in an inaccurate, incomplete and misleading closing price.

Nasdaq argues that it must exclude ECNs from the proposed closing cross because there is "uncertainty and delay associated with order delivery trading interest" from ECNs.[3] Taking Bloomberg Tradebook as an example of one ECN, our statistics show that when Nasdaq sends orders to Bloomberg Tradebook, a fill is completed 97% of the time. The remainder is attributable to race conditions of various forms. When a fill is not achieved, there is no appreciable uncertainty or delay. In fact, Bloomberg Tradebook responds to order delivery within milliseconds. Bloomberg Tradebook's fill rate and its response time should satisfy any reasonable criteria for certainty and speed.

If the performance of Bloomberg Tradebook is typical of ECNs participating in SuperMontage — and we have no reason to believe it is not — Nasdaq does not have any legitimate basis for excluding ECN orders from the closing cross on the basis of delay. Even if Nasdaq can document that there are ECNs with delayed response times, there is a non-discriminatory solution to the problem. Nasdaq can simply amend its closing cross algorithm to put a cap on the time in which ECNs must respond. For example, if an ECN does not respond within the designated turnaround time, the order would not be filled. Nasdaq has not shown why it is necessary to exclude ECNs with a superior price from the SuperMontage matching algorithm. Indeed, by doing so, the Closing Cross Proposal would contravene Nasdaq's own rule of price/time priority within SuperMontage, one of the fundamental unifying principles of its design.

Nasdaq's exclusion of ECNs from its proposed closing cross would harm ECNs and their investor participants as well as broker-dealers. It would also be harmful to the broader market, particularly given the percentage of SuperMontage volume attributable to ECNs, a percentage that is likely to increase in the near future. The Nasdaq Closing Cross Proposal would ignore internal ECN liquidity that in many cases would provide significant price improvement. Excluding ECN liquidity when calculating the Nasdaq Official Closing Price (the "NOCP") would compromise the quality and reliability of the NOCP as a benchmark for mutual funds and various indices. For the mutual funds, in particular, the NOCP is needed to accurately calculate the Net Asset Value of funds at the end of each trading day. Ignoring ECN liquidity that may offer price improvement also would make it more difficult for broker-dealers participating in SuperMontage to meet their best-execution obligations.

Nasdaq's professed concern about "uncertainty" arising from including ECNs also is unfounded. Indeed, there are appropriate ways to include in a SuperMontage closing

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[3]   *Id.*

cross the publicly displayed liquidity offered by order-delivery participants. We have presented to Nasdaq a proposal that would effect a closing cross without excluding order-delivery participants. In brief, instead of first determining a hypothetical closing cross price and then performing executions at this price, Nasdaq could reverse the sequence. In that way, it could progressively match against both auto-execution and order-delivery liquidity, and this process would determine a representative closing price after the aggregate trading interest of all participants was accommodated. In this alternative algorithm, orders SuperMontage would receive from order-delivery participants would be easily handled and would provide for a close determined on the basis of actual executions.

We have prepared and presented to Nasdaq a more detailed description of our proposed alternative algorithm. If the Commission would find it helpful in its deliberations concerning Nasdaq's Closing Cross Proposal, we can provide complete specifications of the algorithm to the Commission for its review. The point is that there are alternatives that avoid the unnecessary discrimination built into the Closing Cross Proposal.

The Closing Cross Proposal, in addition to being flawed in its design, is illegal. As the Commission knows, Section 15A(b)(6) of the Securities Exchange Act of 1934 (the "Exchange Act") requires that the rules of a securities association not be designed "to permit unfair discrimination between customers, issuers, brokers, or dealers." Nasdaq has not provided any basis for excluding from its Closing Cross Proposal ECNs that elect not to participate in automatic executions on SuperMontage. Technical solutions within SuperMontage's current configuration to the one potential problem Nasdaq has identified are readily available. There are also more comprehensive alternative algorithms that can be developed and deployed to address the potential concerns raised by non-auto-ex ECNs. We have already presented one such alternative in detail to Nasdaq.

In addition to discriminating against ECNs, the Closing Cross Proposal would discriminate against mutual funds and broker-dealers. In the Release, Nasdaq states that the Closing Cross Proposal is consistent with the provisions of Section 15A(b)(6) because "it would result in the public dissemination of information that more accurately reflects the trading in a particular security at the close."[4] Nowhere in the Release does Nasdaq explain how excluding ECN liquidity from the NOCP will yield more accurate trading information at the close. Indeed, excluding ECN liquidity from the closing cross would make it more difficult for mutual funds accurately to calculate their NAVs, as they must do under the Investment Company Act of 1940, or for broker-dealers to meet their best-execution obligations. Section 15A(b)(6) also requires that the rules of a national securities association "remove impediments to and perfect the mechanism of a free and open market and a national market system." By walling off an essential facility of its market from key participants, Nasdaq's proposal would impose a direct impediment to free and open markets and would weaken the national market system.

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[4]   *Id.*, in text after footnote 8.

Section 15A(b)(8) of the Exchange Act requires that the rules of a national securities association provide a fair procedure for "the prohibition or limitation by the association of any person with respect to access to services offered by the association or a member thereof." We respectfully submit to the Commission that Nasdaq's Closing Cross Proposal, in addition to discriminating against ECNs in direct contravention of Section 15A(b)(6) of the Exchange Act, also constitutes a constructive denial to ECNs of access to an essential service offered by Nasdaq, that is, full participation in the proposed closing cross.

Section 15A(b)(9) of the Exchange Act requires that the rules of a national securities association "not impose any burden on competition not necessary or appropriate in furtherance of the purposes of this title." In arguing that the Closing Cross Proposal is consistent with its obligations under Section 15A(b)(6), Nasdaq simply ignores the consequences of the proposal. With respect to its obligations under Section 15A(b)(9), Nasdaq provides a mechanical and formulaic disclaimer that effectively denies the existence of any competition with ECNs. As the Commission well knows, ECNs compete with Nasdaq and the advent of SuperMontage has made that competition even keener. The Closing Cross Proposal would deny ECNs access to participation in the SuperMontage closing cross, access that is essential for the clients of ECNs. We respectfully submit to the Commission that the constructive denial of access to essential services and facilities of an exchange or national securities association, particularly where that denial falls upon competing liquidity centers, imposes upon an exchange or a national securities association a presumption that it has imposed an unnecessary and inappropriate burden on competition. Nasdaq seeks to discharge its obligation under Section 15A(b)(9) with a mere affirmation that it does not believe its proposal is an unnecessary or inappropriate burden on competition. Such a rote disclaimer is inadequate on its face.

For these reasons, we respectfully advise the Commission that it may not lawfully approve the Closing Cross Proposal in its current form and that the Commission should direct the NASD to revise its proposal to eliminate its discriminatory provision, to include ECNs that do not accept automatic executions on SuperMontage and to provide access for them to participation in the closing cross. For the reasons set forth above, a Commission order approving the Closing Cross Proposal in its current form would be reversible as a matter of law.

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　　　　　　　We hope that our letter is helpful to the Commission and the staff in its review of the Closing Cross Proposal. If members of the Commission or of the staff believe we may be of further assistance in these matters, please let us know.

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　　　　　　　　　　By:　*Kim Bang*

cc:　　　　　The Hon. William H. Donaldson, Chairman
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