



March 18, 2005

Mr. Jonathan G. Katz  
Secretary  
U.S. Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549-0609

**Re: Amendments No. 1 and 2 to Best Execution Rule  
Release No. 34-51229; File No. SR-NASD-2004-026**

Dear Mr. Katz:

The Ad Hoc Best Execution Committee (the “Committee”) of the Securities Industry Association<sup>1</sup> (the “SIA”) is pleased to offer comment on the referenced rule filing (the “Proposed Rule Change”), which seeks to amend NASD Rule 2320(a) (the “Best Execution Rule”).

As detailed in our previous comment letters,<sup>2</sup> SIA shares NASD's concerns about alleged trading abuses by certain market participants and wishes to work with NASD to ensure that adequate safeguards are in place to combat such abuses. We agree with NASD that best execution obligations provide important protections to investors, and we

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<sup>1</sup> The Securities Industry Association brings together the shared interests of nearly 600 securities firms to accomplish common goals. SIA's primary mission is to build and maintain public trust and confidence in the securities markets. At its core: Commitment to Clarity, a commitment to openness and understanding as the guiding principles for all interactions between investors and the firms that serve them. SIA members (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs nearly 800,000 individuals, and its personnel manage the accounts of nearly 93 million investors directly and indirectly through corporate, thrift, and pension plans. In 2004, the industry generated an estimated \$227.5 billion in domestic revenue and \$305 billion in global revenues. (More information about SIA is available at: [www.sia.com](http://www.sia.com).)

<sup>2</sup> NASD issued Notice to Members 02-40 in July 2002, seeking comment on whether the scope of the Best Execution Rule should be clarified to include customer orders received by a member from another broker-dealer. SIA expressed concern with the proposals in the NTM in a September 2002 comment letter to NASD. See Letter from the Trading and Self-Regulation and Supervisory Practices Committees of SIA to NASD, dated September 9, 2002, regarding NTM 02-40. NASD subsequently filed Amendment No. 1 to the Proposed Rule Change with the Securities and Exchange Commission (“SEC”) on May 11, 2004. SIA's Ad Hoc Best Execution Committee (which includes members of the Trading and Self-Regulation and Supervisory Practices Committees) met with NASD staff on the Proposed Rule Change on June 2, 2004 to discuss its views, and submitted a comment letter to NASD on August 17, 2004. See Letter from Ad Hoc Best Execution Committee to NASD, dated August 17, 2004, regarding SR-NASD-2004-026, Amendment No. 1 (the “SIA August 2004 Letter”).

believe it is important that NASD periodically review these and other existing regulatory requirements to ensure that investors continue to be afforded a high level of protection.

The Committee generally believes Amendment No. 2 to the Proposed Rule Change to be a significant improvement over prior versions. The Committee wishes to commend the NASD staff for their continued willingness to refine the rule filing in light of industry comments and their adoption of several of the Committee's clarifying suggestions. In particular, we appreciate the staff's reconsideration and removal of the provision calling for written agreements between the broker-dealer originating an order ("originating broker-dealer") and the broker-dealer that receives such an order for execution ("recipient broker-dealer"). We found that concept to be one of the most problematic aspects of Amendment No. 1.

We also note and appreciate the staff's inclusion of "compliance with the terms and conditions of the order, as communicated by the originating broker-dealer" as a factor in determining whether a recipient broker-dealer has exercised "reasonable diligence" in processing the order. However, it was our hope that the revised rule proposal would make clear that a recipient broker-dealer's compliance with the terms and conditions of the order, as communicated by the originating broker-dealer, would constitute satisfaction of its best execution obligation with regard to such routed orders. As currently written, however, Amendment No. 2 to the Proposed Rule Change lists such compliance with the terms and conditions of the order as just one of several factors to consider when determining a recipient broker dealer's exercise of "reasonable diligence."

Therefore, the Committee would like to take this opportunity to submit this brief letter to better clarify its position. Specifically, for purposes of subparagraph (a)(1) of the Proposed Rule Change, we believe that a recipient broker-dealer should be deemed to have satisfied its best execution obligation if it executes the order in accordance with the terms and conditions of such order, as communicated by the originating broker-dealer. As explained below, we believe this formulation of the rule will provide investors with the fundamental protections embodied by the Proposed Rule Change, while taking into account the fact that recipient broker-dealers do not have access to clients of originating broker-dealers (*i.e.*, the persons creating the orders).

NASD makes clear that the originating broker-dealer retains its own best execution obligation in connection with customer orders. As a practical matter, an originating broker-dealer will typically satisfy its best execution obligation by: (1) reviewing all of the factors that would constitute the exercise of reasonable diligence (*i.e.*, character or market, size and type of transaction, number of markets checked, location and availability of quotation); and (2) examining those factors with reference to what it knows about the particular customer (*i.e.*, what the customer emphasizes in execution of its orders). Thus, as communicated by the originating to the recipient broker-dealer, the final order will have encapsulated in its particular terms the originating broker-dealer's best execution analysis. The recipient broker-dealer, with no access to the customer and, thus, no ability to perform an independent analysis of such factors with reference to that

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customer, should be permitted to rely on the terms and conditions of such order as representing the most well-informed and well-reasoned best execution analysis possible.

Because the current proposal suggests that compliance with the terms and conditions of the order is only one of several factors to be considered by the recipient broker-dealer, we believe the proposal does not fully recognize the differing roles of the originating broker-dealer and the recipient broker-dealer and their relative access to customer information. The fact remains that the recipient broker-dealer usually has no knowledge of the actual customer, and is therefore not in the same position as the routing firm to weigh the relative importance of the various factors as they relate to the customer.

We respectfully request, therefore, that NASD clarify its Proposed Rule Change to state that a recipient broker-dealer should be deemed to have satisfied its best execution obligation if it executes the order in accordance with the terms and conditions of such order, as communicated by the originating broker-dealer. We believe this position recognizes (i) the proper exercise of reasonable diligence, as performed by the originating broker-dealer, and (ii) the preferences of the customer, as determined by the originating broker-dealer based on their knowledge of that customer.

We appreciate the opportunity to provide these comments and welcome the opportunity to continue this dialogue with the NASD or SEC staff. If you have any questions, you may contact the undersigned at 212-608-1500 or 202-216-2000.

Very truly yours,

Amal Aly  
Vice President and  
Associate General Counsel

Ann Vlcek  
Vice President and  
Associate General Counsel

cc: Chairman William H. Donaldson  
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