INSTINET GROUP

March 22, 2005

Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: <u>File No. SR-NASD-2004-026; Notice of Filing of Proposed Rule Change and Amendments Nos. 1 and 2 Thereto to Amend NASD Rule 2320(a) Governing Best Execution</u>

Dear Mr. Katz,

Introduction

Instinet Group Incorporated (Instinet Group) welcomes the opportunity to comment on the above-referenced proposed rule change ("Proposed Rule"), in which the NASD seeks to amend NASD Rule 2320(a) (the "Rule").[1] Instinet Group, through affiliates, is the largest global electronic agency securities broker and has been providing investors with electronic trading solutions and execution services for more than thirty-five years. We operate our two main businesses through Instinet, LLC[2] and Inet ATS, Inc. (INET).[3]

I. Summary of Proposal

NASD is proposing to amend the Rule to provide that a broker-dealer that receives an order for execution ("recipient broker-dealer") from another broker-dealer ("originating broker-dealer") has obligations under the Rule if the order is a customer order. NASD also is proposing to add "compliance with the terms and conditions of the order, as communicated by the originating broker-dealer" as one of the factors to be considered in determining whether a recipient broker-dealer has exercised "reasonable diligence" in processing the order. In addition, NASD is updating some of the terminology used in the Rule to account for changes in the market since the Rule was last revised.

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[1] Exchange Act Rel. No. 51229 (Feb. 18, 2005), 70 FR 9416 (Feb. 25, 2005).

[2] Instinet, LLC, branded as Instinet, the Unconflicted Institutional Broker, gives its customers the opportunity to use its sales-trading expertise and advanced technology tools to interact with global securities markets, improve trading and investment performance and lower overall trading costs. Instinet acts solely as an agent for its customers, including institutional investors, such as mutual funds, pension funds, insurance companies and hedge funds. Additional information regarding Instinet, LLC can be found at http://www.instinet.com.

[3] INET, the electronic marketplace, provides its U.S. broker-dealer customers one of the most robust liquidity pools in Nasdaq equities, substantial liquidity in U.S. exchange-listed securities, and routing access to other major U.S. trading venues. Additional information regarding INET can be found at http://www.inetats.com.

II. NASD Should Amend the Proposal to Deem a Recipient Broker-Dealer to Have Exercised Reasonable Diligence If It Executes an Order in Accordance with the Terms and Conditions Communicated by the Originating Broker-Dealer

Instinet Group agrees fully with the position expressed in the comment letter on the Proposed Rule submitted by the Securities Industry Association ("SIA").[4] Specifically, we request that NASD revise the proposal to provide that a recipient broker-dealer should be deemed to have exercised reasonable diligence if it executes an order in accordance with the terms and conditions communicated by the originating broker-dealer. As noted in the SIA Letter, such a revision will afford investors the fundamental protections embodied in the Rule, while recognizing that recipient broker-dealers do not have access to clients of originating broker-dealers and therefore are not in the same position as the originating broker-dealer to weigh the relative importance of the various factors set forth in the Proposed Rule.[5]

In this regard, the terms and conditions expressed in the final order routed to a recipient broker-dealer will encapsulate the originating broker-dealer's best execution analysis. Therefore, allowing the recipient broker-dealer to rely on such terms and conditions will enable the order to be executed based upon the most well-informed and well-reasoned best execution analysis possible.[6]

III. NASD Should Redress the Unfair Competitive Disparity the Proposed Rule Would Create Between Otherwise Similarly Situated Market Centers Operated by NASD Member Broker-Dealers and Those Operated by NASD and other SROs.

The Proposal would create an unfair competitive disparity between otherwise similarly situated market centers that execute orders on an electronic agency basis. Specifically, the Proposed Rule would not apply to market centers operated by NASD and other SROs (including NASDAQ's Market Center and Brut Facility and the Archipelago Exchange), but it would apply to ECNs and ATSs (including INET) operated by NASD member firms. These SRO- and non-SRO-operated market centers all systemically execute orders based on the express terms and conditions received from originating broker-dealers. By requiring member-operated ECNs and ATSs to consider factors other than the express terms and conditions of an order, the Proposed Rule would impose systemic, operational, and other burdens on these market centers alone and consequently upsets the competitive balance between member- and SRO-operated

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[4] See Letter from Amal Aly and Ann Vlcek, Vice Presidents and Associate General Counsel, SIA, to Jonathan G. Katz, Secretary, SEC, dated March 18, 2005 ("SIA Letter").
[5] Id. at 2-3.
[6] Id.

electronic agency market centers. Instinet Group believes that NASD should redress this potential competitive imbalance by revising the Proposed Rule to specifically exclude member-operated ECNs or ATSs that interact with orders on a fully automated basis from the Rule, or, alternatively, apply the same obligations imposed under the Proposed Rule to NASDAQ Market Center and the Brut Facility to retain a competitive balance among the market centers operating within NASD's regulatory authority.

IV. The Commission or NASD Should Consider Delaying the Implementation of the Proposed Rule Until Such Time as the Commission Adopts and Provides Interpretive Guidance on Market Centers' Obligations under the Trade-Through Proposal of Regulation NMS

Instinet Group also believes that the approval of the Proposed Rule may be premature, given likely Commission action on reproposed Regulation NMS in the near future[7] and its far-reaching implications for the regulatory framework governing interaction among market centers in the national market system, which may create conflicts or raise interpretive issues with the Proposed Rule. For example, the Commission's proposed trade-through rule would provide an exception for an order received by a market center that is identified as an intermarket sweep order.[8] In its current form, the plain language of the Proposed Rule could be interpreted to require the market center (i.e., the recipient broker-dealer) to consider routing the order to another market center displaying a better price even though the originating broker-dealer already has indicated that it has attempted to access such interest.

To avoid such potential conflicts or interpretive issues from arising between the Rule and Commission rules, we believe that the Commission and NASD should consider delaying the adoption and implementation of any revised Rule until such time as the Commission takes final action on Regulation NMS and issues the necessary interpretive guidance to enable market centers to fully understand the implications of the Commission's trade-through rule on their operations and interaction with other market centers.

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[7] Judith Burns, Lawmaker Questions SEC Data Supporting Mkt Reforms, Dow Jones Newswires (Mar. 17, 2005) (stating SEC expected to vote on Regulation NMS on April 6, 2005) and Reuters News, SEC Heads for April Showdown on Markets Overhaul (Mar. 17, 2005).
[8] See Proposed Rule 611(b)(5) of Regulation NMS.

V. Conclusion

Instinet Group again appreciates the opportunity to offer its comments on the Proposal. If you have any questions regarding our comments, please do not hesitate to contact me directly at 212.310.7548, or Jon Kroeper, FVP and Associate General Counsel, Instinet Group, LLC at 202.898.8438.

Sincerely yours,

Paul A. Merolla
EVP and General Counsel

cc: Annette L. Nazareth, Director, Division of Market Regulation
Robert L.D. Colby, Deputy Director, Division of Market Regulation

Giovanni Prezioso, General Counsel, Office of General Counsel