Securities Industry Association
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May 27, 2005

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

Re: Proposed NASD Rule 2111 to Prohibit Members from Trading Ahead of Customer Market Orders
Release No. 34-51230; File No. SR-NASD-2004-045

Dear Mr. Katz:

The Ad Hoc Best Execution/Manning Committee of the Securities Industry Association[1] ("SIA") is pleased to offer comment on the above-referenced rule filing (the "Proposed Rule"), which seeks to adopt NASD Rule 2111 to prohibit members from trading ahead of customer market orders (commonly referred to as the "Market Manning Rule"). SIA supports the concept of a Market Manning Rule and notes that most member firms currently offer Manning protection to their customer market orders. SIA, however, believes that the Proposed Rule needs further clarification, specifically with regard to the requirement that members cross standing customer market orders, the applicability of the Proposed Rule to certain order types and in certain markets, and member firms' use of information barriers.

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[1] 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.) The Ad Hoc Best Execution/Manning Committee, which includes members of SIA's Trading and Self-Regulation and Supervisory Practices Committees, initially met with NASD staff on June 2, 2004 to discuss its views on this Manning proposal, among other issues.

Requirement that Members Cross Standing Customer Market Orders

SIA supports the need to cross standing customer market orders, but believes this portion of the Proposed Rule needs further modification. Proposed NASD Rule 2111(a) states that "[a] member must make every effort to execute a customer market order that it receives fully and promptly." Proposed NASD Rule 2111(c) allows a member who has not immediately executed a customer market order and holds multiple orders on both sides of the market that have not been executed to "*cross or otherwise execute such orders in a manner that is reasonable, and is consistent with the objectives of this rule and with the terms of the orders*." However, where a member does not hold multiple orders on both sides of the market, Proposed NASD Rule 2111(c) requires that a member only "***cross*** such order with any market order, marketable limit order or non-marketable limit order priced better than the best bid or offer . . . " and, unlike above, does not allow for that member to execute the order in any other manner. In such cases, SIA believes that the NASD should not limit such executions to crosses and should allow members to execute such orders by other means consistent with the rule. Some SIA member firms' systems are not able to execute agency crosses if the order resides with the market maker. They are, however, able to proprietarily buy from the market seller, and in turn allocate to a market buyer at the same price. SIA believes that so long as the customer's market order is executed at the proper price under the rule, the rule should be agnostic with regard to the manner in which the order was executed. Therefore, SIA recommends that the rule be amended to allow a member that holds a customer market order that has not been immediately executed *to execute such order in any reasonable manner that meets the pricing requirements of the rule, and is consistent with the terms of the order.* [2]

The Proposed Rule suggests that a member firm is required to cross a marketable limit order even if that limit order were marketable only for a brief period of time. SIA is concerned that flickering quotes would create significant compliance and technology challenges for firms attempting to comply with this requirement. In this regard and as was done with Regulation NMS, SIA believes there should be some recognition in the Proposed Rule of a small period of time in which a given quote would not subject a marketable limit order to such protection.

Certain Order Types to be Excluded from Manning Protection

SIA believes the NASD should specifically exclude from Manning protection the following types of market orders:

1. Orders that are entered on a "not held" basis. Because the member is granted discretion in executing "not held" orders, requiring that a member execute such orders fully and promptly would not be consistent with the terms of the order.

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[2] At least one firm suggests that the NASD should amend the Proposed Rule text to make clear that a member firm could execute customer market orders under the rule as either agent or riskless principal.

2. Orders executed on an agency basis where the customer specifically asks that the order be executed on an agency basis, or the orders are for accounts where the member is bound by another regulation limiting or prohibiting principal transactions.[3]

Proposed Rule To Apply Only to Orders Executed on Nasdaq or in an OTC Market

SIA believes that the Proposed Rule should apply only to orders executed on Nasdaq or in an OTC market, particularly as the NYSE (and possibly other markets) already has a similar rule (NYSE Rule 92) that addresses trading along and the protection of customer orders. Such a limitation furthers recent efforts in the industry to discourage duplicative regulation in our securities markets.

Information Barriers

As with previous NASD limit order protection guidelines,[4] the Proposed Rule should allow firms to more fully utilize information barriers to segregate non-market making desks from other customer order flows. The Proposed Rule, as written, appears to be overly restrictive, and to not allow fully integrated broker-dealers to service their various customers with executions that are different but of equal execution quality.

SIA believes that where a member implements and utilizes an effective system of internal controls, such as appropriate information barriers, that operates to prevent non-market making desks from obtaining knowledge of customer market orders held at the market making desk, those other non-market making desks may continue to trade in a principal capacity at prices that are the same as or inferior to the customer market orders held at the market making desk. SIA notes that, with regard to limit order protection, the NASD stated in Notice to Members 95-43 that "[a]s long as a firm implements and utilizes an effective system of internal controls, such as appropriate "Chinese walls," that operate to prevent the non-market making desk from obtaining knowledge of customers' limit orders, those other desks may continue to trade at prices the same as or inferior to the customers' limit orders." Therefore, for consistent treatment of both market and limit orders under Manning, SIA urges NASD to recognize a member's use of information barriers under proposed NASD Rule 2111.

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SIA respectfully requests that NASD clarify its Proposed Rule in accordance with the above recommendations. SIA believes that these clarifications further the objectives of the Proposed Rule, and thus afford appropriate protections of investors' orders.

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[3] Firms have provided the following examples of such orders: a) orders executed by a broker subject to ERISA; b) orders executed by a broker subject to the Investment Advisers Act of 1940; c) orders that were solicited for IRA accounts; and d) any other orders where the broker is a fiduciary of the account for which the order was executed.

[4] NASD Notice to Members 95-43.

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
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