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June 23, 2010

By e-mail

Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090
rule-comments@sec.gov

Re: Market Structure Roundtable (File No. 4-602)

Ladies and Gentlemen,

Liquidnet, Inc. appreciates the opportunity to submit this written statement following the recent Securities and Exchange Commission ("Commission") roundtable on market structure issues. Liquidnet would like to thank the Commission for organizing the roundtable and for providing Liquidnet the opportunity to participate. Our written statement discusses issues and proposals set forth in the Commission's rule proposal on "Regulation of Non-Public Trading Interest"[1] and the Commission's "Concept Release on Equity Market Structure."[2]

Commission's tradition of flexibility in the rulemaking process

As part of the current rulemaking process, the Commission should provide appropriate flexibility to allow for existing and future innovations that reduce trading costs for investors.

In connection with the adoption of Regulation NMS, the Commission issued a series of exemptive orders and interpretive responses relating to a variety of trading scenarios, including order-delivery ECN trades, average-price benchmark trades, qualified contingent trades, trades involving the conversion of foreign ordinary shares to ADRs, intra-day VWAP trades, average price residual trades, benchmark ETF trades, trades in non-convertible preferred securities, trades involving average price orders with guaranteed prices and manually negotiated principal trades.[3]

[1] Securities Exchange Act Release No. 60997 (November 13, 2009), 74 FR 61208 (November 23, 2009), http://sec.gov/rules/proposed/2009/34-60997.pdf (accessed June 21, 2010). ("Rule Proposal on Regulation of Non-public Trading Interest")
[2] Securities Exchange Act Release No. 61358 (January 14, 2010), 75 FR 3594 (January 21, 2010), http://sec.gov/rules/concept/2010/34-61358.pdf (accessed June 21, 2010). ("Concept Release")
[3] U.S. Securities and Exchange Commission, Division of Trading and Markets, "Responses to Frequently Asked Questions Concerning Rule 611 and Rule 610 of Regulation NMS" (last updated on April 4, 2008), http://www.sec.gov/divisions/marketreg/nmsfaq610-11.htm (accessed June 21, 2010). ("Regulation NMS FAQs")

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Several of these interpretations were documented in exemptive orders issued by the Commission, including two exemptive orders issued to Liquidnet.[4] Other interpretations were documented as part of the Regulation NMS FAQs. For example, the Commission issued an interpretation to facilitate negotiation of agency block transactions.[5] Our negotiation system executes 91% of trades at the mid-point,[6] but there are negotiations where both parties bid and offer at or within the NBBO and a change in the NBBO during the negotiation period could cause the execution price to fall outside the NBBO as of the time of execution. The Commission's interpretation has been helpful to facilitate block negotiations where both parties seek to negotiate block orders in good faith at or within the NBBO.

These interpretations, as intended, facilitated the implementation of Regulation NMS and evidence the importance of flexibility in the rulemaking process. The Commission traditionally has taken a practical approach in connection with the rulemaking process to account for individual situations where an exception might be appropriate and would not otherwise impede the intended objectives of the Commission's proposed rule. We recommend that the Commission adopt a similar approach in connection with the current rulemaking process, consistent with the Commission's historical practice.

Block IOIs[7]

The Commission proposes to reduce the ATS order display threshold from 5% to .25%.[8] We are concerned that the proposal as currently written would restrict our ability to execute institutional block orders most efficiently on behalf of our buy-side customers.[9]

We have proposed a modification to the Commission's proposal to allow for institutional block IOIs, subject to the following conditions: the institutional customer is informed and consents in advance to the sending of the block IOI; any block order received in response to the block IOI is executed for block size; and significant price improvement is provided to both sides of the trade.

The perception of IOIs is poor, but the use of institutional IOIs has helped Liquidnet achieve best execution of customer orders.[10] In 2008, BrokerEdge™ ranked Liquidnet #1 in execution quality for

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[4] Securities Exchange Act Release No. 52514 (September 27, 2005), "Order Granting Exemption to Liquidnet, Inc. from Certain Provisions of Regulation ATS under the Securities Exchange Act of 1934", http://sec.gov/rules/exorders/34-52514.pdf (accessed June 21, 2010). Securities Exchange Act Release No. 53193 (January 30, 2006), "Order Granting Exemption to Liquidnet, Inc. from Certain Provisions of Rule 612 of Regulation NMS under the Securities Exchange Act of 1934", http://sec.gov/rules/exorders/34-53193.pdf (accessed June 21, 2010).

[5] Regulation NMS FAQs, Question 3.23.

[6] Liquidnet trading data, January through May 2010.

[7] We use the term "block" as a short-hand for what is referred to as a "large size order" in the Commission's Rule Proposal on Regulation of Non-Public Trading Interest.

[8] Rule Proposal on Regulation of Non-Public Trading Interest, 74 FR at 61210.

[9] Diagram 1 illustrates the challenge faced by institutions in executing block orders.

institutional orders across all global brokers.[11] As shown in Diagram 2, we similarly were ranked #1 in the most recent BrokerEdge™ report for 2009, covering the period from Q4 2008 through Q3 2009.[12] It could be challenging for any broker, including Liquidnet, to retain the #1 ranking every year, but we typically have performed well in third-party studies measuring execution quality. We note more generally that agency-only brokers as a whole tend to perform well in surveys of execution quality.

Institutional IOIs also can help retail customers achieve 100% price improvement for their orders. One retail broker participating in our H2O system routes orders to H2O in response to IOIs that we send to the retail broker's smart order router.[13] The resulting executions provide 100% price improvement to the retail customer (and to our institutional customer).[14] Because of latency concerns, the retail broker would not route orders to us if we could not provide these IOIs.

In its comment letter on the Concept Release, Credit Suisse presents Rule 605 data for 2009 that internalizing dealers provide approximately 6% price improvement of customer orders and exchanges provide approximately negative 10% price improvement of customer orders.[15] According to the same source, our Liquidnet H2O system, which uses institutional IOIs, currently provides 94% price improvement for customer orders.[16]

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[10] The negative perception of IOIs can be attributed to several concerns. One concern is the practice of brokers sending IOIs without the customer's knowledge and consent. Our first proposed condition is intended to address this concern. A second concern is the use of IOIs for non-block orders. Our second proposed condition is intended to address this concern. A third concern is the bypassing of displayed limit orders. Our third proposed condition is intended to address this concern. We would appreciate the opportunity to discuss with the Commission any additional conditions that would address any additional potential concerns regarding our proposed modification.

[11] Investment Technology Group "ITG Broker Edge™ Core Broker Report" for U.S. trades for the four quarters ended December 31, 2008, cited in April 30, 2009 press release, "Liquidnet Ranked #1 in 62% of all Execution Categories According to ITG Broker Edge™ Core Broker Report".

[12] Tradewatch, *Pensions & Investments*, March 8, 2010, http://www.pionline.com/apps/pbcs.dll/article?AID=/20100308/CHART/100309924&crit=liquidnet&template=printart (accessed March 22, 2010).

[13] Diagram 3 illustrates the participation of brokers (including retail brokers), exchanges and other participants in our H2O system.

[14] Price improvement = 1 – effective spread/quoted spread. The 100% price improvement computation is based on a comparison of the execution price to the NBBO at the time of execution. An alternate way to measure price improvement is to compare the execution price to the NBBO at the time of order receipt (see Footnote 16 below).

[15] Letter dated April 21, 2010 from Daniel Mathisson, Managing Director, on behalf of Credit Suisse Securities USA, LLC, http://sec.gov/comments/s7-02-10/s70210.shtml (accessed June 21, 2010), pp. 5 and 14.

[16] Rule 605 data compiled by Thomson Transaction Analytics Reports, January to May 2010. Rule 605 data allows for a computation of price improvement based on a comparison of the execution price to the NBBO at the time of order receipt, again with price improvement = 1 – effective spread/quoted spread. Using this computation, and applying the computation to orders that qualify as covered orders under Rule 605, Liquidnet H2O provides 94% price improvement for customer orders. The difference between the 100% and 94% price improvement computations could be attributable to movement in the NBBO between order receipt and order execution and the exclusion of certain orders from Rule 605 reporting.

Our proposed modification will preserve our ability to reduce execution costs for institutional orders and provide significant price improvement for all customer orders, including institutional, retail, and broker-dealer orders.

The Commission notes in its recent rule proposal for a "Consolidated Audit Trail" that, "the duty of best execution requires broker-dealers to execute customers' trades at the most favorable terms reasonably available under the circumstances, i.e., at the best reasonably available price."[17] Rules should be adopted with appropriate flexibility so the ability of market participants to achieve best execution of customer orders is not impeded.

Fair access

In the Concept Release, the Commission requests comment on whether it would be advisable to reduce the Regulation ATS fair access threshold from 5% to a lower percentage.[18] If the threshold were reduced, it is important to provide interpretive guidance that admission criteria reasonably designed to protect the confidentiality of institutional block order information would be consistent with the fair access requirement.

In connection with the reduction of the ATS fair access threshold that was adopted as part of Regulation NMS, the Commission issued an exemptive order to Liquidnet exempting our negotiation system from this change.[19] We believe that this exemptive order should remain in effect. More importantly, the principles underlying this exemptive order -- in particular, the important policy objective of protecting the confidentiality of institutional block order information -- should help inform future interpretive guidance that the Commission provides with respect to fair access.

Definition of a large institutional order

We propose that a large institutional order, for purposes of the Commission's rule proposal on "Regulation of Non-Public Trading Interest" and for similar rules, be defined as follows:

Issuer market cap category	Minimum principal amount
Large cap stocks (market cap of $10B or more)	$200,000 minimum principal amount
Mid cap stocks (market cap of $1B or more and less than $10B)	$125,000 minimum principal amount
Small cap stocks (market cap of less than $1B)	$50,000 minimum principal amount

[17] Securities Exchange Act Release No. 62174 (May 26, 2010), 75 FR 32556 (June 8, 2010), http://sec.gov/rules/proposed/2010/34-62174.pdf (accessed June 21, 2010), at 75 CFR 32578, citing Newton v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 135 F.3d 266, 270 (3d Cir.), cert. denied, 525 U.S. 811 (1998). ("Consolidated Audit Trail Rule Proposal")
[18] Concept Release, 75 FR at 3614.
[19] Fair Access Exemptive Order, p. 5.

Our proposed minimum principal amount thresholds are based on detailed internal data we have reviewed for negotiated executions for these categories of stocks.[20]

May 6 flash crash

We are pleased to report that we did not have one customer issue on May 6 as our customers continued to execute trades only within their limit prices. The events of May 6 illustrate the benefits of systems like Liquidnet that provide institutional traders increased control over their orders. We are pleased to see that the exchanges are working together to provide for cross-market stock-by-stock circuit breakers, and we support the Commission's efforts to ensure that cross-market stock-by-stock circuit breakers are implemented.[21] We support the Commission's stated intention to extend the pilot to ETFs and to additional stocks beyond the S&P 500, and we would suggest that a higher percentage volatility threshold would be appropriate for certain less liquid stocks. We also support the Commission's stated intention to consider price limits as either an alternative or supplement to circuit breakers. We also support the Commission's recent efforts to improve the process for resolution of erroneous trades.

We also support the Commission's review of market orders. We would question the value of market orders when investors can set wide limits to achieve the same purpose as a market order. If a retail customer wants to set a limit price of zero on a sell order, or a limit price of infinity on a buy order, why not provide that the retail customer do so explicitly?

Finally, we commend the Commission and the Commodity Futures Trading Commission for their detailed report on the events of May 6[22] and their efforts to implement various recommendations in the report, as described in this section. The Commission's specific proposals in response to the events of May 6 present the Commission with a historic opportunity to protect against a recurrence of these types of events in the future.

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[20] As an alternative, the Commission could set three categories based on ADV. Under this alternative, stocks with the highest ADV would have a minimum principal amount of $200,000, stocks with the next level of ADV would have a minimum principal amount of $125,000, and stocks with the lowest level of ADV would have a minimum principal amount of $50,000.

[21] See, Securities Exchange Act Release No. 62252 (June 10, 2010), "Self-Regulatory Organizations; BATS Exchange, Inc.; EDGA Exchange, Inc.; EDGX Exchange, Inc.; NASDAQ OMX BX, Inc.; International Securities Exchange LLC; New York Stock Exchange LLC; NYSE Amex LLC; NYSE Arca, Inc.; The NASDAQ Stock Market LLC; Chicago Stock Exchange, Inc.; National Stock Exchange, Inc.; Chicago Board Options Exchange, Incorporated; Order Granting Accelerated Approval to Proposed Rule Changes Relating to Trading Pauses Due to Extraordinary Market Volatility", 75 FR 34186 (June 16, 2010), http://sec.gov/rules/sro/bats/2010/34-62252.pdf (accessed June 21, 2010).

[22] "Preliminary Findings Regarding the Market Events of May 6, 2010, Report of the Staffs of the CFTC and SEC to the Joint Advisory Committee on Emerging Regulatory Issues," May 18, 2010, http://sec.gov/sec-cftc-prelimreport.pdf (accessed June 21, 2010).

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Previous recommendations

We would like to reiterate the specific recommendations from our prior comment letters:[23]

- Improved disclosure of order handling practices by institutional brokers to their customers
- Improved disclosure of execution quality to retail investors
- Centralization of market surveillance under FINRA
- Immediate reporting of all electronic executions and a flag to identify manual executions
- Modifications to Regulation ATS to enhance the regulation of alternative trading systems.

We also have recommended that the Commission provide greater clarity regarding trades executed at a small increment above the best bid or a small increment below the best offer, which has raised concerns for retail and institutional investors. Perhaps the Commission could issue a report --similar to the report on the May 6 flash crash -- that provides data about the types of trades being executed at small increments above the best bid or below the best offer. In the report, the Commission also could clarify its position as to whether such trades are being executed in compliance with Regulation NMS.

Large trader reporting; consolidated audit trail

We support the Commission's recent rule proposals with respect to large trader reporting and a consolidated audit trail.[24] Two of the key questions to be considered in analyzing the events of May 6 are: which market participants were selling at irrationally low prices?; and why? With a consolidated audit trail, the Commission could more readily answer these important questions.

Mom and pop

We want to reinforce that our customers are mutual funds and other buy-side institutional investors that trade on behalf of tens of millions of individual investors. Everything Liquidnet does that reduces execution costs for institutional investors translates into increased savings for the beneficiaries of the accounts that our institutional customers manage.

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[23] Letter dated December 21, 2009 from Seth Merrin, Anthony Barchetto, Jay Biancamano, Vlad Khandros and Howard Meyerson, Liquidnet, Inc., http://sec.gov/comments/s7-27-09/s72709-25.pdf (accessed June 21, 2010). Letter dated March 26, 2010 from Seth Merrin, Howard Meyerson and Vlad Khandros, Liquidnet, Inc., http://sec.gov/comments/s7-27-09/s72709-82.pdf (accessed June 21, 2010).

[24] Securities Exchange Act Release No. 61908 (April 14, 2010), 75 FR 21456 (April 23, 2010), http://sec.gov/rules/proposed/2010/34-61908.pdf (accessed June 21, 2010). Consolidated Audit Trail Rule Proposal. We intend to submit more specific comments on these rule proposals.

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Conclusion

We would like to thank the Commission for the opportunity to submit this written statement to supplement our previous comment letters and roundtable testimony on these issues.

Very truly yours,

Seth Merrin, Chief Executive Officer

Howard Meyerson, General Counsel

Vlad Khandros, Corporate Strategy

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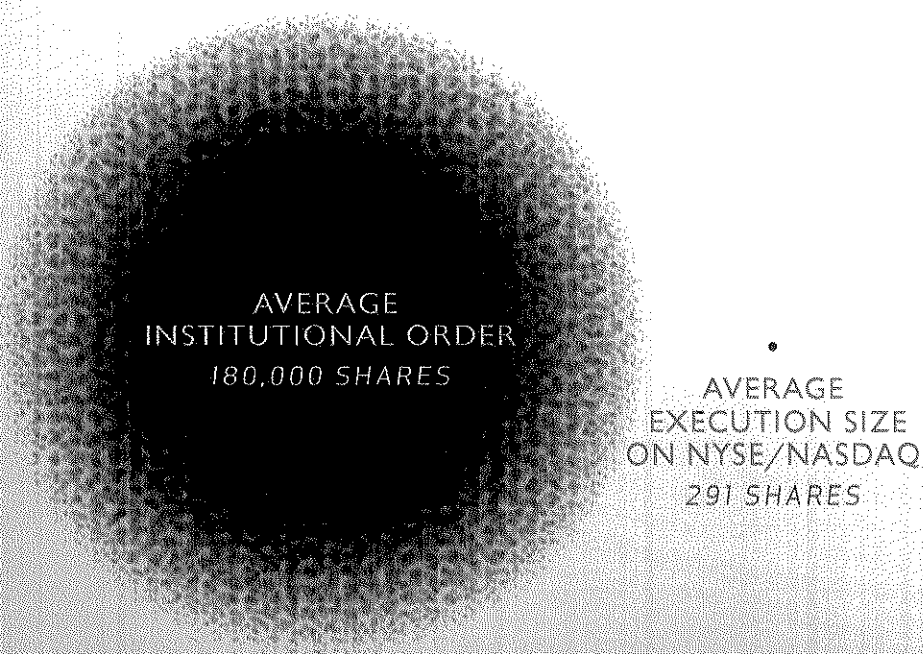
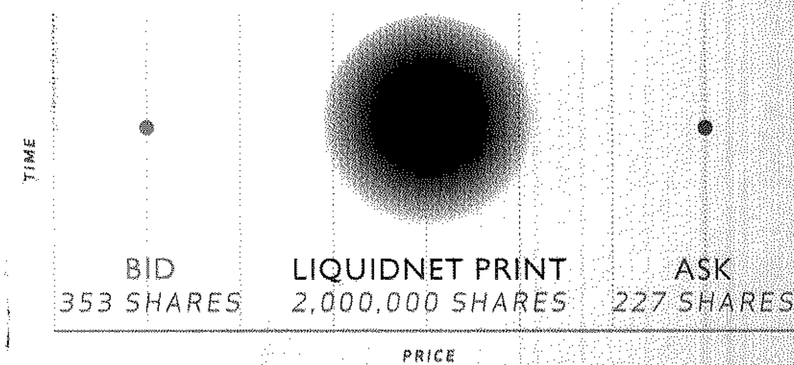
THE PROBLEM FOR INSTITUTIONS

SUPPLY/DEMAND DISPARITY[1]



ACTUAL INSTITUTIONAL TRADE[2]



LIQUIDNET BUY-SIDE TO BUY-SIDE EXECUTION WAS OVER 5,000 TIMES THE DISPLAYED LIQUIDITY AND WAS EXECUTED AT THE MID

[1] Q1 Data Source: Liquidnet, NYSE & NASDAQ

[2] Source: Liquidnet & Bloomberg

DIAGRAM I

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#1 IN EXECUTION QUALITY

ACCORDING TO *BROKER EDGE*[3]

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LARGE TRADES	VALUE ADDED
LIQUIDNET	34 BPS
BROKER 2	34 bps
BROKER 3	16 bps
BROKER 4	14 bps
BROKER 5	12 bps
BROKER 6	9 bps
BROKER 7	2 bps
BROKER 8	1 bps
BROKER 9	0 bps

MORE THAN 50,000 SHARES

MEDIUM TRADES	VALUE ADDED
LIQUIDNET	22 BPS
BROKER 2	17 bps
BROKER 3	6 bps
BROKER 4	1 bps
BROKER 5	-1 bps
BROKER 6	-2 bps
BROKER 7	-2 bps
BROKER 8	-3 bps
BROKER 9	-3 bps

10,000–50,000 SHARES

SMALL TRADES	VALUE ADDED
LIQUIDNET	19 BPS
BROKER 2	15 bps
BROKER 3	8 bps
BROKER 4	7 bps
BROKER 5	1 bps
BROKER 6	0 bps
BROKER 7	-1 bps
BROKER 8	-2 bps
BROKER 9	-2 bps

LESS THAN 10,000 SHARES

[3] "Tradewatch." Pensions & Investments 8 Mar. 2010. Print. Includes all brokers (core brokers and specialty brokers).

DIAGRAM 2

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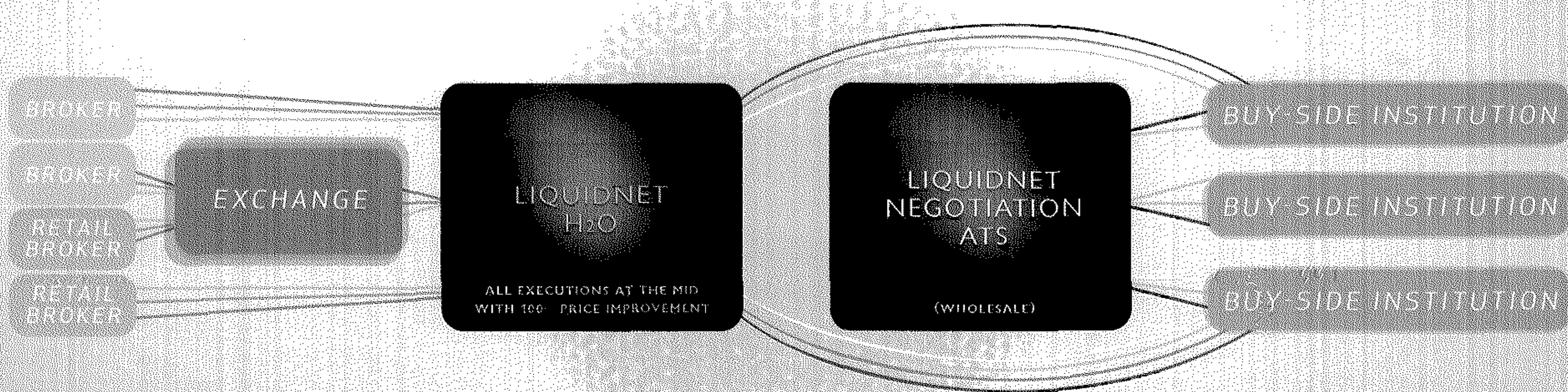
WHOLESALE MEETS RETAIL AT THE MID

100% PRICE IMPROVEMENT



FOR THE FIRST TIME INSTITUTIONS SUPPLY LIQUIDITY TO RETAIL.
MORE LIQUIDITY. DIFFERENT INTERACTION OF LIQUIDITY. DISINTERMEDIATION.
100% PRICE IMPROVEMENT FOR ALL RETAIL AND INSTITUTIONS ON ALL H2O EXECUTIONS.

DIAGRAM 3